PENSION BENEFIT GUARANTY CORPORATION

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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C O N T E N T S

PENSION BENEFIT GUARANTY CORPORATION

WEDNESDAY, SEPTEMBER 24, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:07 a.m., in room 1100 Longworth House Office Building, Hon. John Lewis (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
September 16, 2008
OV–7

CONTACT: (202) 225–5522

Chairman Lewis Announces a Hearing on the Pension Benefit Guaranty Corporation

House Ways and Means Health Subcommittee Chairman John Lewis (D–GA) today announced that the Subcommittee on Oversight will hold a hearing on the Pension Guaranty Corporation ("PBGC"). **The hearing will take place at on Wednesday, September 24, 2008, at 10:00 a.m., in the main Committee hearing room, 1100, Longworth House Office Building.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Representatives of PBGC and the U.S. Government Accountability Office ("GAO") have been invited to testify. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

PBGC is a Federal corporation established under the Employee Retirement Income Security Act ("ERISA") of 1974 (P.L. 93–406), as amended. It currently guarantees payment of basic pension benefits earned by 44 million American workers and retirees participating in about 30,500 defined-benefit pension plans.

PBGC is funded by insurance premiums paid by plan sponsors, assets received from terminated plans, and investment income from PBGC assets. As of September 30, 2007, PBGC reported a deficit of $13.1 billion in the single-employer pension insurance programs and a deficit of $955 million in the multi-employer pension insurance program. While ERISA specifically states that the U.S. Government is not obligated to pay PBGC's obligations, PBGC's 2007 Annual Report states that, if the corporation fails to address its deficit, eventually plan sponsors, participants, and "possibly taxpayers" will bear the burden. In the 2007 Annual Report, PBGC estimates that there is only a 23 percent chance of reaching full funding within the next ten years.

In July 2003, GAO designated PBGC's single-employer pension insurance program as a high-risk program that needs broad-based transformations and warrants Congressional attention. In January 2007, GAO continued to list PBGC as a high risk area and noted in its *High Risk Series* that PBGC-insured plans had cumulative underfunding of $350 billion, including $73 billion in plans sponsored by financially weak firms. In addition, GAO has investigated and issued recommendations with respect to various aspects of PBGC's operations, including reports on the investment strategy and governance structure.

In announcing this hearing, Chairman Lewis said: **"PBGC plays a vital role in our retirement system and our economy. The operation of PBGC is a concern for workers, plan sponsors, and the American taxpayer. The Congress must make sure that PBGC is governed responsibly and operates efficiently."**

FOCUS OF THE HEARING:

The Subcommittee will review the financial condition, operations, and governance of PBGC. The hearing will focus on the deficit in the single-employer pension insurance program, the change in investment policy, and the governance weaknesses identified by GAO. The Subcommittee also will examine the overall status of the defined-benefit pension system, including the rise in the number of frozen or voluntarily terminated plans.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov/*, select "110th Congress" from the menu entitled, "Committee Hearings" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, complete all informational forms and click "submit" on the final page. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Wednesday, October 8, 2008**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, and telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov.*

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman LEWIS. Good morning. The hearing is now called to order. The Chair would like to apologize to the Members and witnesses for being a little late this morning.

But before we begin, I would like to welcome the distinguished gentleman from North Dakota, Mr. Pomeroy, and the distinguished gentleman from Texas, Mr. Johnson, and thank them for joining us at this hearing.

I also would like to make a few remarks about two of our Subcommittee Members. First, I would like to pause to remember our dear friend and sister, Stephanie Tubbs Jones, who we lost last month. There's a void that can never been filled, but we each carry her commitment to helping people who need a voice, and she will live on in our work here on this panel, and in our lives. She was a dedicated and committed public servant, a friend, and she will be deeply missed.

I would like to pause now for a moment of silence in her memory.

[Pause.]

Chairman LEWIS. Thank you.

Because this year is quickly coming to a close, I believe this will be the last hearing of the Subcommittee on Oversight for the 110th Congress. So, I would also like to take a moment to recognize my dear friend and Ranking Member, Jim Ramstad of Minnesota, who is retiring from Congress this year. Mr. Ramstad and I have served on this panel together for many, many years, and they have been wonderful years, and we have always worked well together. We have worked together and have had many successes together on this Committee.

Jim, I want to thank you for you service to this Committee, and to our country, and for your friendship over the years. You will be missed by me and this Subcommittee, and by all of the people you have served over the years. Thank you so much for your service.

Mr. RAMSTAD. Thank you, Mr. Chairman. This is a bitter-sweet moment for me. I deeply appreciated most of all your friendship over the past 18 years, as well as your leadership of this Subcommittee, the way you've conducted not only yourself but the Committee's business. You've always reached out in a bipartisan way and upheld this Subcommittee's proud tradition of bipartisanship.

I'll miss you, Mr. Chairman. You are my friend and brother. I'll miss the staff, who have been so helpful, particularly Chris and Carrin back here from my staff; but all the staff, including Reggie. I'll miss you all.

But I might be leaving Congress, but I'm not leaving public service, and I look forward to serving in other ways and staying in touch with all of you.

Thank you, Mr. Chairman.

Chairman LEWIS. Thank you very much, Jim.

Today the Subcommittee on Oversight will review the Pension Benefit Guaranty Corporation. The Corporation plays a vital role in our retirement system; it guarantees basic pension benefits for 44 million working Americans.

I am deeply concerned with the current financial position of the Corporation and retirement security. In 2007 it was reported that pension plans insured by the Corporation were underfunded by $350 billion. Further, the Corporation has a $14 billion deficit.

The recent turmoil on Wall Street only makes it more important that we examine the financial condition of the Corporation and the

plans it insures. We need a true and complete understanding of its position for the sake of the workers, employers, and taxpayers.

It would be good to know why there are almost 37,000 Americas who are missing their pension benefits, benefits valued more than $200 million. These numbers are too high.

I look to hearing from our witnesses today. Thank you for being here.

I am pleased to recognize the distinguished Ranking Member, my dear friend and brother, Mr. Ramstad, for his opening statement.

Mr. RAMSTAD. Thank you, Mr. Chairman.

As you state so well, the Pension Benefit Guaranty Corporation is truly one of the stewards of the American workers' retirement security, and as such Congress must remain committed to active oversight of the PBGC. By the same token the PBGC must be responsive and cooperative with each and every request from Congress. It works both ways.

With more than 44 million Americans insured by the PBGC, Mr. Chairman, we must guarantee sound governance and management, so retirement income will be available, will be there for those who need it.

That's why I must say it's troubling that the PBGC reported a $14 billion deficit at the end of last fiscal year, even as it's Single Employer Program remains exposed to the threat of future terminations of large unfunded pension plans.

I'm also concerned about the recent investment allocations instituted by the PBGC that would invest more of its trust fund assets in equities. GAO's testimony notes that the new allocation will likely carry more risk than acknowledged by PBGC's analysis.

Now I understand the need for the PBGC to earn a good return on its assets, but we cannot risk unrecoverable losses through stock investments. We've seen huge stock declines, as you point out, Mr. Chairman, in many companies that were previously considered blue chip companies.

Although the PBGC's liabilities are not explicitly backed by the full faith in credit of the United States, this doesn't mean there is no risk to the taxpayer. If the PBGC becomes financially insolvent, Congress may find it necessary to bail out the PBGC at taxpayer expense. That's the last thing Congress and the American people want, another bailout.

Congress can help promote the solvency of pension plans by not needlessly penalizing investments in the stock market, where so many of his nation's public and private pension plan assets are invested. To that end, Mr. Chairman, I hope Congress extends the 15 percent maximum tax rate on capital gains and dividend income, and the zero-percent rate for those in the lowest two income tax brackets.

Many seniors also rely on capital gains and dividends, and it would be a shame if Congress raised taxes on retirement income, particularly with so much recent market turmoil.

Mr. Chairman, thanks again for calling this hearing. I'm looking forward to hearing from the witnesses as the PBGC is truly a crucial concern for American workers. Thank you, Mr. Chairman. I yield back.

Chairman LEWIS. Thank you, Mr. Ranking Member.

Now we will hear from our witnesses. I ask that you limit your testimony to 5 minutes. Without objection, your entire statement will be included in the record.

It is now my pleasure and delight to introduce the Director of the Pension Benefit Guaranty Corporation, Mr. Charles Millard.

STATEMENT OF CHARLES E. MILLARD, DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Mr. MILLARD. Thank you, Mr. Chairman, Ranking Member Ramstad, and Subcommittee Members. I appreciate the opportunity to appear before you today to discuss the state of the Pension Benefit Guaranty Corporation, and we welcome your oversight.

The Orations's pension insurance program covers 44 million workers, retirees, and beneficiaries in 30,000 private defined benefit pension plans. When an underfunded plan terminates because the employer can no longer fund the promised benefits, PBGC takes over the plan as trustee and pays benefits to the full extent permitted by law.

PBGC payments are important, often crucial to the retirement income security of retirees and workers. At the end of fiscal year 2007 PBGC was paying benefits to 630,000 individuals in trusteed plans. Another 530,000 people in these plans will be eligible to receive benefits in the future.

Created by Congress under ERISA, the PBGC is a wholly owned Federal corporation with a three-member board. The Secretary of Labor is the chair of the board and the Secretaries of Commerce and Treasury also sit on the board. Under the Pension Protection Act of 2006, the Orations's. is now headed by a Senate-confirmed director, and I am proud to be the first person approved for this important position. We have an advisory Committee appointed by the President, that provides guidance on a number of matters, including investment policy.

PBGC is self-financed, receives no funds from general tax revenues, and its obligations are not backed by the full faith and credit of the U.S. Government. PBGC's statutorily created revolving funds receive premiums, which are invested in U.S. treasuries. PBGC also has trust funds which hold assets from trusteed plans and recoveries from employers. The trust funds can be invested in more varied holdings, consistent with sound fiduciary principles.

The Corporation has been in a deficit position for most of its 34 years. At the end of fiscal year 2007, we had a $14 billion deficit, with some $82 billion in long-term liabilities, versus $68 billion in assets. Fortunately, we have sufficient funds to meet our benefit obligations for a number of years. Nevertheless, the deficit is a significant and continuing concern.

Pension underfunding in companies with below-investment-grade debt ratings has been the main source of past claims and comprises reasonably possible terminations for the future.

PBGC actively works to limit risk exposure and keep pension plans ongoing. Since 2005 we have successfully sought arrangements with some 13 auto parts companies, including Dana and Dura Automotive to emerge successfully from bankruptcy without

terminating their plans. We are very proud of the work of our group in this area.

Earlier this month, General Motors agreed to file to take over $3.4 billion worth of liabilities for Delphi's hourly plans. Chrysler's plans received $200 million in contributions beyond ERISA requirements, and Daimler will provide a $1 billion guarantee for up to 5 years against plan termination.

The Deficit Reduction Act of 2005 and the Pension Protection Act of 2006 changed PBGC premiums, guarantee rules, and reporting and disclosure requirements. We have issued proposed and final regulations on a variety of these provisions, and expect to complete work on most of all of them by the end of next year.

We also look forward to the funding reforms in the 2006 legislation taking hold, but it is too early to tell the effect they will have on the funded status of plans that constitute reasonably possible terminations.

The President's Fiscal Year 09 budget continues to recommend legislation giving PBGC's board the ability to adjust premiums and provide some level of risk-based premium-setting authority.

The Bush Administration has long taken a comprehensive approach to strengthening the pension system and beginning in 2004 developed reforms that led to the passage of the 2006 legislation. Under the leadership of Secretary Chow, PBGC's board has taken a consistently active role in guiding the Corporation, meeting 12 times since 2003.

Let me also mention some steps we've taken more recently to build for the future. In February, our board unanimously adopted a more diversified investment policy to better enable PBGC to meet its long-term obligations. We have reduced the time it takes to issue final benefit determinations to participants, in some case shortening this process by over a year.

Improvements we have made on information technology have led OMB to take us off its management watch list. We're currently transitioning 80 percent of our employees to invitations performance plans, which are key to our actual strategic plan. PBGC continues to receive among the highest American customer satisfaction ratings in the government, and in May our board adopted new bylaws to clarify the roles of the board, the director, and senior management.

Companies that sponsor pension plans have a responsibility to live up to the promises they make to their workers and retirees, but when a company can no longer keep its promises, workers and retirees need a strong Federal insurance system as a safety net.

We are building on the 2006 reforms and making internal improvements to strengthen this critical program.

Thank you, Mr. Chairman. I would be happy to answer any questions.

[The prepared statement of Mr. Millard follows:]

Statement of The Honorable Charles E. F. Millard, Director, Pension Benefit Guaranty Corporation

Testimony of Charles E.F. Millard, Director
Pension Benefit Guaranty Corporation
before the
Committee on Ways and Means
Subcommittee on Oversight
United States House of Representatives

Mr. Chairman, Ranking Member Ramstad, and Members of the Subcommittee: Good morning. I appreciate the opportunity to appear before the Subcommittee today and to discuss the state of the Pension Benefit Guaranty Corporation ("PBGC" or "Corporation").

The need for a pension safety net became starkly evident when, at the end of 1963, the Studebaker Corporation, then the nation's oldest major automobile manufacturer, closed down its U.S. operations and terminated its pension plan. About 4,000 workers age 40-59 lost the bulk of their pensions, receiving only fifteen cents for each dollar of their vested benefits. These individuals had an average age of 52. They had worked for the company an average of almost 23 years.

In 1974 Congress passed the Employee Retirement Income Security Act ("ERISA") which, among other pension protections, created the PBGC to insure pensions earned by American workers under private-sector defined benefit plans. Today PBGC insures almost 44 million workers, retirees, and beneficiaries in over 30,000 plans. When a plan terminates in an underfunded condition – because the employer responsible for the plan can no longer fund the promised benefits – the Corporation takes over the plan as trustee and pays benefits to the full extent permitted by law.

PBGC benefit payments are important, often crucial, to the retirement income security of retirees and workers in trusteed plans, many of whom worked decades for their promised benefits. At the end of fiscal year 2007, PBGC was paying benefits to 630,000 retirees and beneficiaries in terminated underfunded plans; another 534,000 participants in these plans will become eligible to start receiving benefits in the future.

Since Congress established the PBGC in 1974, the Corporation has faced many challenges, including economic contraction in certain industries that traditionally have provided defined benefit pensions; inadequate minimum contribution requirements which too often have resulted in unfunded promises at plan termination; premiums that often have been inadequate to meet the financial demands placed on the PBGC program; and employer shifts from defined benefit plans to defined contribution plans, which are not insured by PBGC.

Because of these challenges, PBGC has been in a deficit position for most of its existence. At the end of fiscal year 2007, PBGC had assets of $68.4 billion to cover liabilities of $82.5 billion, resulting in an accumulated deficit of $14.1 billion.[1] Fortunately, the current

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[1] There was a $13.1 billion deficit in the single-employer program and a $1 billion deficit in the multiemployer program at the end of FY 2007.

deficit does not pose an imminent threat; PBGC has sufficient funds to meet its obligations for a number of years. Nevertheless, over the long term, the deficit must be addressed.

Defined Benefit Pensions

Private-sector defined benefit plans cover 43.8 million American workers, retirees, and beneficiaries. In a defined benefit plan, retirement benefits typically are based on a worker's earnings and years of service with the employer. Defined benefit plans insulate retirees from investment and mortality risk and are intended to be a source of stable retirement income.

Defined benefit plans are funded by employer contributions. The law prescribes minimum contribution requirements, which Congress has tightened over the years to improve plan funding. Benefits under a defined benefit plan are secure if the employer is financially healthy and can afford to make the required contributions. When an employer can no longer afford a plan, the plan is terminated and PBGC guarantees benefits, subject to legal limitations. Amounts above guarantee limits can be paid only if plan assets or recoveries from employers are sufficient to allocate to these benefits.

Thus retirement income security for the workers and retirees covered by private defined benefit plans depends on a combination of sound plan funding and a strong insurance program.

Governance and Financial Structure

PBGC is a wholly-owned federal government corporation with a three-member Board of Directors—the Secretary of Labor, who is the Chair, and the Secretaries of Commerce and Treasury. Until August 2006, ERISA provided that the Corporation was to be administered by the Chairman of the Board in accordance with policies established by the Board, and Board Chairmen appointed non-statutory executive directors who reported to the Chairman. The Pension Protection Act of 2006 ("PPA 2006") established a Senate-confirmed Director to administer the Corporation in accordance with policies established by the Board of Directors.[2] PBGC also has an Advisory Committee appointed by the President.

In May of this year PBGC's board revised the Corporation's bylaws to address concerns expressed by GAO in a July 2007 report. The new bylaws more clearly define the roles and responsibilities of PBGC's board members, representatives, director, and senior management.

PBGC operates two insurance programs, which are financially separate. The Single-Employer program covers 33.8 million workers, retirees, and beneficiaries in about 28,900 single-employer plans. The smaller Multiemployer program – which covers collectively bargained plans that are maintained by two or more unrelated employers – protects 10.0 million workers, retirees, and beneficiaries in about 1,500 multiemployer plans.

Although PBGC is a government corporation, it receives no funds from general tax revenues and by law its obligations are not backed by the full faith and credit of the U.S. government. Operations are financed by insurance premiums, assets from pension plans trusteed by PBGC, investment income, and recoveries from the companies formerly responsible for underfunded trusteed plans (generally only pennies on the dollar).

PBGC's statutorily established revolving funds receive premiums, which are invested in U.S. Treasury obligations. PBGC also has trust funds, which hold the assets of terminated underfunded plans that PBGC has taken over as trustee. The Government Accountability Office has determined that the trust funds are private, nongovernmental moneys. The trust funds can be invested in more varied holdings consistent with sound fiduciary principles.

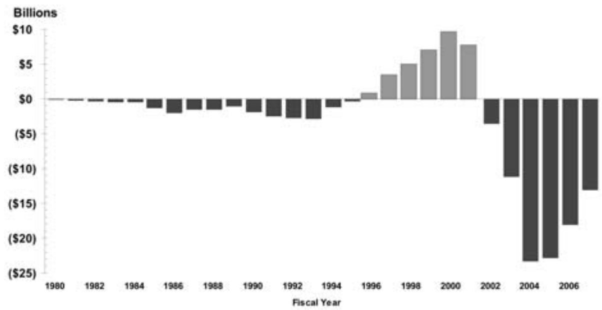
PBGC pays participant benefits from its revolving funds. PBGC revolving funds are then partially reimbursed by the trust fund. This partial reimbursement results in what is referred to as "proportional funding" of benefits; that is, funded benefits are paid with trust fund assets and unfunded guaranteed benefits are paid with revolving fund assets.

PBGC's administrative expenses are also provided from the revolving fund (also subsequently reimbursed from its trust funds) and are subject to an explicit limitation on obligations through the appropriations process. PBGC's appropriations language provides certain exceptions from this limitation that allow the agency to obtain additional resources in the event of additional plan terminations. As a result of this format, PBGC neither requests nor receives any taxpayer support.

Deficit and Claims History

PBGC's operating results are subject to significant fluctuation from year to year, depending on the severity of losses from plan terminations, changes in the interest factors used to discount future benefit payments, investment performance, general economic conditions, and other factors such as changes in law. Unfortunately, as the chart below shows, the Corporation has been in a deficit position for most of its existence.

PBGC Net Position
Single-Employer Program
FY 1980 – FY 2007



Data does not include restored LTV plans in 1986

The $13.1 billion deficit in the single-employer program at the end of FY 2007 is the difference between assets of $67.2 billion and liabilities of $80.4 billion. Liabilities include claims from actual terminations and probable terminations. Probable terminations are claims that are expected to occur and are required to be booked as liabilities under generally accepted accounting standards. Notwithstanding the $13.1 billion deficit in the single-employer program, I want to reiterate that the PBGC has sufficient assets on hand to continue paying benefits for a number of years. However, with $80 billion in liabilities – which includes actual and probable terminations – and only $67 billion in assets as of the end of the past fiscal year, the single-employer program lacks the resources to fully satisfy its benefit obligations.

The large accumulated deficit that persists in the single-employer program is due to an unprecedented wave of pension plan terminations with substantial levels of underfunding in recent years. The program posted its largest year-end shortfall in the agency's 34-year history in FY 2004, when losses from completed and probable pension plan terminations totaled $14.7 billion for the year, and the program ended the year with an accumulated deficit of $23.3 billion.

The table below shows the ten largest plan termination losses in PBGC's history. Nine of the ten have come since 2001. The top ten claims are primarily from firms in the steel and airlines industries.

Top 10 Firms	Number of Plans	Fiscal Year(s) of Plan Terminations	Claims (by firm)	Vested Participants	Percent of Total Claims (1975-2007)
Top 10 Firms Presenting Claims (1975-2007) PBGC Single-Employer Program[1]					
1. United Airlines	4	2005	$7,503,711,171	122,541	21.5%
2. Bethlehem Steel	1	2003	3,654,380,116	91,312	10.5%
3. US Airways	4	2003, 2005	2,684,542,754	57,002	7.7%
4. LTV Steel*	6	2002, 2003, 2004	2,134,985,884	83,094	6.1%
5. Delta Air Lines	1	2006	1,740,482,711	13,028	5.0%
6. National Steel	7	2003	1,275,628,286	33,737	3.7%
7. Pan American Air	3	1991, 1992	841,082,434	31,999	2.4%
8. Trans World Airlines	2	2001	668,377,106	32,275	1.9%
9. Weirton Steel	1	2004	640,480,970	9,410	1.8%
10. Kaiser Aluminum	7	2004, 2007	602,132,764	18,402	1.7%
Top 10 Total	36		$21,745,804,196	492,800	62.2%
All Other Total	3,747		13,193,241,357	1,087,787	37.8%
TOTAL	3,783		$34,939,045,553	1,508,587	100.0%

[1] Data are preliminary.

Total claims for FY 1975-2007 also are concentrated in those industries, with about 41 percent from the airlines industry, about 36 percent from steel and other metals, about 13 percent from other manufacturing industries, and about 11 percent from all other industries.

**PBGC Claims by Industry (FY 1975-2007)
Single-Employer Program[1]**

Industry	Total Claims	
AGRICULTURE, MINING, AND CONSTRUCTION	$613,939,852	1.8%
MANUFACTURING	17,308,736,681	49.5%
Apparel and Textile Mill Products	1,076,787,054	3.1%
Fabricated Metal Products	1,214,284,207	3.5%
Food and Tobacco Products	303,415,234	0.9%
Machinery Manufacturing	1,158,396,474	3.3%
Primary Metals	11,499,713,070	32.9%
Rubber and Miscellaneous Plastics	359,864,357	1.0%
Other Manufacturing	1,696,276,286	4.9%
TRANSPORTATION AND PUBLIC UTILITIES	14,582,003,027	41.7%
Air Transportation	14,205,842,014	40.7%
Other Transportation and Utilities	376,161,013	1.1%
INFORMATION	50,012,420	0.1%
WHOLESALE TRADE	429,453,930	1.2%
RETAIL TRADE	427,810,561	1.2%
FINANCE, INSURANCE, AND REAL ESTATE	793,408,855	2.3%
SERVICES	733,680,227	2.1%
TOTAL	$34,939,045,553	100.0%

[1] Data are preliminary.

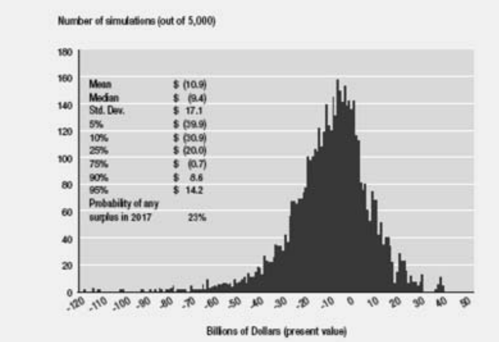
Projections

ERISA requires that the PBGC annually provide an actuarial evaluation of its expected operations and financial status over the next five years. PBGC has historically made a 10-year forecast for the single-employer program. The forecast is made using a stochastic model—the Pension Insurance Modeling System ("PIMS")—to evaluate its exposure and expected claims. PIMS portrays future underfunding under current funding rules as a function of a variety of economic parameters. The model recognizes that all companies have some chance of bankruptcy and that these probabilities can change significantly over time. The model also recognizes the uncertainty in key economic parameters (particularly interest rates and stock returns).

The model simulates the flows of claims that could develop under thousands of combinations of economic parameters and bankruptcy rates. PIMS is not a predictive model and it does not attempt to anticipate behavioral responses by a company to changed circumstances.[3] PIMS starts with data on the PBGC's single-employer net position (a $13.1 billion deficit in the case of FY 2007) and data on the funded status of approximately 460 plans that are weighted to represent the universe of PBGC-covered plans. The model produces results under 5,000 different simulations. The probability of any particular outcome is determined by dividing the number of simulations with that outcome by 5,000.

Even with the strong economy and improved deficit in FY 2007, and the legislated premium increases and reforms, the model showed a median and mean deficit of about $10 billion at the end of the 10-year period. Even more significantly, the model indicated that there was only a 23 percent chance that PBGC could reach full funding at the end of that 10-year period.

DISTRIBUTION OF PBGC'S POTENTIAL 2017 FINANCIAL POSITION



3 Additional information on PIMS and the assumptions used in the model are available in PBGC's Pension Insurance Data Book 1998, pages 10-17, which also can be viewed on the PBGC's Web site at *www.pbgc.gov/publications/databook/databk98.pdf.*

Underfunding Exposure

Much of the projected deficit in the PIMS model is reflective of the underfunding in covered defined benefit plans. Most companies that sponsor defined benefit plans are financially healthy and should be capable of meeting their pension obligations to their workers. But the amount of underfunding in pension plans sponsored by financially weaker employers is very substantial. Pension underfunding in non-investment grade companies is classified under generally accepted accounting standards as PBGC's "reasonably possible" of termination and is required to be reported in the notes to PBGC's financial statements.

PBGC's reasonably possible exposure by industry for FY 2006 and FY 2007 is shown in the table below.

Reasonable Possible Exposure (Dollars in billions)		
Principal Industry Categories	**FY 2007**	**FY 2006**
Manufacturing	$31.4	$37.6
Transportation, Communication & Utilities	19.5	20.5
Services & Other	6.9	7.0
Wholesale and Retail Trade	5.8	6.1
Agricultural, Mining and Construction	1.0	1.2
Finance, Insurance and Real Estate	1.2	0.9
Total*	**$65.7**	**$73.3**

* Numbers may not add due to rounding.

In 2007, as in previous years, the PBGC engaged in a number of activities to safeguard the pension insurance system, including plan risk assessments, plan monitoring, and negotiation and litigation, to limit risk exposure and losses to pension plan participants and the PBGC. PBGC monitored some 2,200 controlled groups, some 3,600 plans, and almost 500 bankruptcy cases. The PBGC takes an active role in corporate bankruptcy proceedings on behalf of workers whose pension plans are not fully funded. The PBGC encourages plan sponsors to continue rather than terminate their pension plans. When a plan is terminated, the PBGC pursues recoveries of the underfunding from the plan sponsor and other related companies that are liable.

The steps PBGC has taken to protect pensions that could be adversely affected by corporate transactions or bankruptcy have made a real difference to plan participants and PBGC. And the companies that cooperated in making good on their pension promises have reason to be proud.

- Since 2005, the PBGC has worked with 13 auto parts companies that have emerged successfully from Chapter 11 protection without terminating their pension plans. For example, this year, Dana Corporation (53,000 participants), and Dura Automotive (4,300 participants) made contributions required by ERISA during bankruptcy and kept their plans intact. Other examples in prior years are Federal Mogul and Tower Automotive.

- Last spring the PBGC initiated discussions with Daimler and Cerberus that led to additional protections for Chrysler's pension plans (259,500 participants). The plans received $200 million in contributions beyond what is required by ERISA, and Daimler will provide a $1 billion guarantee for up to five years if the plans terminate.
- Delphi's bankruptcy proceedings remain ongoing, and PBGC is continuing its efforts to protect Delphi's pension plans (86,500 participants) and achieve the goal of a successful reorganization. On September 12 Delphi announced an agreement with General Motors under which Delphi will transfer $3.4 billion of net pension liabilities from Delphi's hourly pension plan to GM's hourly pension plan. The agreement is subject to bankruptcy court approval. The bankruptcy court may hold a hearing this week.

As the insurer of America's defined benefit pension plans, the PBGC will continue to negotiate protection for workers and retirees in transactions like those described above. These safeguarding activities provide significant protection to the defined benefit insurance system and all its stakeholders.

2006 Pension Reforms

In 2005, the Administration proposed a comprehensive package of pension reforms to shore up the PBGC and strengthen funding in ongoing defined benefit plans. During 2006, legislation incorporating some of these reforms was signed into law: the Deficit Reduction Act of 2005 ("DRA 2005"), enacted on February 8, 2006, and the Pension Protection Act of 2006, enacted August 17, 2006.

Premiums

The provisions of the 2006 legislation that have the most immediate effect on PBGC are the premium provisions. The new law increased both the single-employer and multiemployer flat-rate premiums.

Until the enactment of DRA 2005, the flat-rate premium had remained unchanged for single-employer plans since 1991 and for multiemployer plans since 1989. DRA 2005 changed the per-participant flat-rate premium for plan years beginning in 2006 to $30 (from $19) for single-employer plans and to $8 (from $2.60) for multiemployer plans, and provides for inflation adjustments to the flat rates for future years. The inflation-adjusted per-participant flat-rate premium for 2008 is $33 for single-employer plans and $9 for multiemployer plans.

PPA 2006 kept the variable-rate premium paid by single-employer plans at $9 per each $1,000 of unfunded vested benefits and conformed the measurement of underfunding to the PPA changes to the plan funding rules. PPA 2006 also eliminated the full-funding limit exemption from the variable-rate premium, which was a loophole under prior law.

The President's FY 2009 budget again called upon Congress to grant PBGC's Board of Directors the ability to adjust premiums in order to eliminate PBGC's $14 billion deficit over a reasonable period of time and better safeguard workers' benefits. Moreover, under current law, PBGC is required to charge the same premiums regardless of the financial

health of the plan's sponsor. Normally, insurance is provided by institutions that are able to underwrite risk, and PBGC should be permitted to assess its premiums in this way. Some level of risk-based premium-setting authority would allow the PBGC to quantify and be better prepared to confront the risks it faces.

DRA 2005 created a new ''termination premium'' that is payable in the event of certain distress and involuntary plan terminations of underfunded single-employer plans that occur after 2005.[4] The premium is $1,250 per participant per year and is payable for three years following the termination. For plans that terminate while the sponsor is in bankruptcy, payment is deferred until the sponsor emerges from bankruptcy. Flatware maker Oneida Ltd., which terminated an underfunded plan while in a chapter 11 reorganization proceeding, asserts that all of its pension plan obligations, including the termination premium, were discharged in bankruptcy. The 2nd Circuit Court of Appeals has agreed to hear PBGC's argument that the Deficit Reduction Act of 2005 requires payment of the termination premium. The appeals court may take up the case by year end.

Funding

PPA 2006 contains funding reforms that first apply to contributions for plan years beginning in 2008. We look forward to these reforms taking hold but it is too early to tell what effect they will have on the funded status of plans that constitute reasonably possible terminations.

While generally trying to improve plan funding, Congress also provided funding relief to certain airlines, allowing them to defer the accelerated funding requirements. This funding relief resulted in certain large plans previously classified as probable terminations being changed to the reasonably possible classification in FY 2006. If PBGC's deficit were calculated without regard to PPA 2006 airline relief provisions, PBGC estimates that its net deficit for FY 2007 would have been approximately $8 billion higher (assuming 2006 underfunding levels for the specific airline plans remained constant).[5] The airline underfunding remains a potential claim against the insurance program that may be expected to grow over time.

Regulations

PPA 2006 and DRA 2005 changed premiums, guarantee rules, reporting and disclosure requirements, and PBGC's missing participants program. During FY 2007, the PBGC began developing and drafting the numerous rules that would amend its regulations to comply with the changes. In developing these regulations, the PBGC seeks to ease and simplify employer compliance whenever possible, taking into account the needs of small businesses. In line with these principles, the PBGC published two final rules implementing premium changes.[6] Together, these rules implemented the new termination premium and changes to the flat-rate and variable-rate premiums discussed above, and a new cap on the variable rate premium for plans of small employers. PBGC also published procedures

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[4] PPA 2006 make changes to the termination premium rules of DRA permanent.
[5] *PBGC FY 2007 Annual Report*, page 17.
[6] Variable-Rate Premium, 73 Fed. Reg.15065 (Mar. 21, 2008); Flat Premium Rates, Variable-Rate Premium Cap, and Termination Premium, 72 Fed. Reg. 71222 (Dec. 17, 2007).

under the PPA provision allowing certain single-employer plans (generally union staff plans) to elect to be multiemployer plans.

In FY 2008, the PBGC published proposed rules on PPA changes to annual financial and actuarial information reporting under ERISA section 4010, multiemployer withdrawal liability, disclosure of termination information, and the guarantee snapshot date for plans that terminate while the sponsor is in bankruptcy.

In FY 2009 PBGC expects to publish proposed rules on other PPA provisions, including the expanded missing participants program.

Terminations

Distress and involuntary termination

Underfunded plans terminate in either a distress termination (initiated by the plan sponsor) or an involuntary termination (initiated by PBGC). In either case, with court approval, PBGC becomes trustee of the plan, taking over plan assets, liabilities, and records.

PBGC immediately notifies plan participants upon becoming trustee and begins gathering the information needed to determine the benefits to which participants are entitled under the plan and the information needed to compute amounts payable under ERISA. The amount to which participants are entitled is the amount guaranteed by the insurance program, plus any additional amounts that can be paid from allocated plan assets or recoveries from employers.

In order to avoid any interruption in benefit payments, PBGC continues payments to retirees while it is making these computations. As quickly as possible, PBGC adjusts benefits and begins paying "estimated benefits" until it can determine the exact amounts due under the law ("final benefits"). Because these early payments are based on estimates, participants may be paid more or less that they are allowed to receive by law. If a participant receives more than allowed by law, future benefits are reduced accordingly. To avoid financial hardship for participants, the reduction is no more than 10 percent of the final monthly benefit and no interest is charged. When repayment is complete, monthly payments increase to the full amount. If a participant or beneficiary dies during repayment, further repayment is waived. If a participant receives less than they are entitled to by law, PBGC pays the difference to the participant in a lump sum with interest.

PBGC works hard to communicate with participants, holding participant meetings, sending individualized letters, and newsletters. However, it is still difficult for a retiree to learn that a pension he has worked years to earn will not be paid in full because the employer has not fully funded what was promised and the amount promised exceeds the legal limits that PBGC can pay.

PBGC is striving to shorten the time it takes to make final benefit determinations and thereby minimize payments in excess of legal limits. We have made great improvements over the years, but there is room for more improvement. Similarly, we are working to improve communications to help manage participant expectations.

Standard termination

In order to terminate in a "standard termination," the plan must pay all benefits promised, including non-vested benefits. The plan administrator must certify to PBGC that this requirement has been met. If the plan administrator is unable to locate a participant, provision must be made for payment of the benefit. Under the PBGC's Missing Participants program, which was established by Congress about twelve years ago, the plan must send money to PBGC or purchase an annuity from an insurance company and provide PBGC information about the annuity purchase so that, if the individual is located, the pension can be paid.

Currently PBGC has $9.3 million in unclaimed benefits under the Missing Participants program and $195.3 million in unclaimed benefits for participants in PBGC-trusteed plans. PBGC conducts repeated searches for all individuals with unclaimed benefits and posts their names in a Pension Search Directory on the PBGC web site. As of mid FY 2007, PBGC had paid $137 million to individuals in the pension search program.

Missing Participants Program Expansion

PPA 2006 provides for expansion of the Missing Participants program to cover terminating private-sector defined contribution plans and terminating multiemployer plans. Under PPA 2006 the expanded program would be effective following issuance of final regulations. PBGC is currently developing proposed regulations for the expanded program.

New Investment Policy

PBGC has total assets of $68.4 billion, of which $55 billion are investible assets. How those funds are invested is a very significant factor in the ability of the Corporation to meet its long-term obligations to the people who look to us for payment of benefits.

PBGC's investment policy was due for Board review in February 2008, so in mid-2007, the PBGC initiated an independent review of PBGC's investment policy in light of PBGC's financial condition and long-term financial needs. We hired an independent consultant that had never worked with PBGC before to conduct a comprehensive review of our long-term liabilities and our asset allocation. This process included the consideration of dozens of possible portfolios under thousands of possible scenarios. During the process, our consultant or PBGC officials met or consulted multiple times with the PBGC Advisory Committee and the PBGC Board Representatives.

After full consideration, PBGC's Board of Directors unanimously adopted a new diversified investment policy on February 12, 2008.

Our consultants calculations concluded that the prior policy gave us only a 19% chance of getting out of our deficit in the next ten years, and that the new policy would give us a 57% chance of achieving that goal. The new policy is designed to take advantage of the PBGC's long-term investment horizon, and will allocate 45 percent of Corporation assets to equity investments, 45 percent to fixed income, and 10 percent to alternative investments such as

private equity. This strategy aims at generating better returns that provide a greater likelihood that the Corporation can meet its long-term obligations.

Evaluation Process

In the months leading up to the adoption of the new investment policy, the Corporation's independent consultant conducted a comprehensive review of the old investment policy and numerous alternative policies. The review included all aspects of PBGC's assets, liabilities, constraints, contingent liabilities, and premium structures, and evaluated PBGC's current and alternative investment policies over 5-, 10- and 20-year periods.

The process that the PBGC conducted to arrive at the conclusion to alter the Corporation's investment policy involved a thorough assessment of PBGC's long-term obligations to plan participants and beneficiaries, exhaustive debate and discussion among numerous constituents, and in-depth analysis by leading industry experts. At the inception of the process, the Corporation's long-term objective and guiding principles were agreed to and documented by several key constituents including Representatives of the Board. This was followed by a close examination of the characteristics of the Corporation's obligations, including duration and key risk factors. A thorough review of the capital market opportunities then explored a wide range of investment policy alternatives. The potential performance of these alternatives and the Corporation's obligations were analyzed in the context of 5,000 economic scenarios over 20-year periods for each portfolio considered. Results across the full range of scenarios were analyzed to identify both expected and worst case environments to gain a thorough understanding of the range of outcomes for the various policy alternatives. The new investment policy was determined to offer the most appropriate balance of liquidity, downside protection, and long-term return potential relative to the Corporation's obligations.

The consultant worked closely with various PBGC departments to understand the underlying nature of PBGC's current and contingent liabilities, cash flow requirements, investment time horizon and investable universe.

The consultant's approach fully considered the unique characteristics of PBGC's liabilities, including the particular risks associated with the contingent liabilities, which are the most significant and uncertain the PBGC faces. The consultant utilized PBGC's benefit payment liability distribution, and contingent liability and premium projections from the Corporation's Pension Insurance Modeling System (PIMS) model in order to develop a detailed projection of PBGC's contingent and trusteed liabilities and benefit payments. Furthermore, the PIMS model also includes projections of contingent liabilities, benefit payments and assets that utilize the consultant's capital market assumptions, including long-term inflation, real interest rates, and market returns. These assumptions (long-term return, risk and correlations for all asset classes) were used to run thousands of simulations quantifying their impact on PBGC's assets, liabilities, funded status, risk and return under a variety of economic and market conditions. The model calculated the range of possible outcomes for each portfolio measured against PBGC's known and contingent liabilities.

The new PBGC investment policy – 45 percent equity, 45 percent fixed income, and 10 percent private equity and other alternative investments – involves a measured

diversification of the portfolio to generate higher returns over the PBGC's long-term investment horizon. This change better enables the Corporation to meet its long-term obligations.

Portfolio Rebalancing

The PBGC will seek to rebalance the investment portfolio at least semi-annually in order to keep its asset allocation consistent with this Investment Policy. The specific timing and size of the rebalancing process will depend upon the liquidity needs of the Corporation, the cost of the rebalancing, anticipated receipt of assets from newly trusteed plans and projected premiums.

Implementation

PBGC has developed a plan for gradual implementation of the new policy to prevent any disruptions in financial markets. The Board Representatives have been deeply involved in crafting the new investment policy and will continue to oversee its implementation. I have established a new Chief Investment Officer position responsible for putting the new investment policy into place and overseeing the Corporation's investment portfolio. The Chief Investment Officer will take the lead in forecasting changes in volume, fund mixes and scheduled maturities of investments and will supervise the Corporation's investment managers.

Operational Improvements

PBGC is making various operational improvements, some of which I have already noted. In July PBGC was removed from the OMB Management Watch List because of the agency's sustained efforts to improve IT project management and to resolve outstanding IT security deficiencies. We also embarked on a program to make constant improvement our goal and part of PBGC's corporate culture. The program is being met with enthusiasm by PBGC's employees. I should note that PBGC always earns high marks in its customer service surveys. PBGC also is rated as one of the top 10 small federal agencies to work for, which also reflects the shared customer focus of its employees and management. We filled management vacancies and are working on succession planning and the new performance management system. PBGC received its 15^{th} consecutive unqualified audit opinion for FY 2007 and is currently working on achieving its 16^{th} for FY 2008.

Conclusion

Companies that sponsor pension plans have a responsibility to live up to the promises they have made to their workers and retirees. But when a company can not keep its promises, workers and retirees need a strong insurance program as a safety net. We are building on the 2006 reforms and making internal improvements to strengthen the safety net.

Thank you, Mr. Chairman. I would be happy to answer questions.

Chairman LEWIS. Thank you very much for your testimony.

Now it's my pleasure and delight to introduce Barbara Bovbjerg from GAO. Welcome.

STATEMENT OF BARBARA D. BOVBJERG, DIRECTOR, EDUCATION, WORKFORCE, AND INCOME SECURITY, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Ms. BOVBJERG. Thank you, Mr. Chairman; Members of the Committee.

I too am pleased to be here today to speak about the challenges facing the Pension Benefit Guaranty Corporation, created by ERISA in 1974. PBGC today insures the retirement benefits of more than 40 million Americans and manages nearly $70 billion in plant assets.

My testimony today describes the role and funding structure of PBGC, the financial challenges it faces, and its issues regarding it's governance and management. My statement is based on reports we've issued over the last several years on these topics.

First, PBGC's role in structure. PBGC is self-financed, a wholly owned Government Corporation that insured defined benefit pension sponsored by private sector employers. PBGC collects premiums from employers, and in the event of a planned default, PBGC assumes control of plant assets and pays benefit amounts due plan participants.

Since 2000 the number of potential beneficiaries has grown from about 500,000, half a million workers and retirees to 1.3 million today.

PBGC's treatment in the Federal budget is complicated. The Corporation has two accounts, has a non-budgetary trust fund, which holds the assets obtained from terminated plans and the on-budget revolving fund, which holds everything else.

The revolving fund reports cash flows from premium collections, interest income, administrative expenses, benefit payments, some of which are financed by reimbursements from the trust fund.

But the trust fund is non-budgetary, when assets are transferred from terminated plans to PBGC, these are not receipts to the government. Similarly, the liabilities that PBGC incurs when it takes over an unfunded plan are also not reflected in the budget. So, PBGC's budgetary treatment is actually thought to distort the Federal fiscal balance as reported.

For example, even as PBGC's long-term deficit grew from $11 billion to $23 billion in 2004, the revolving funds cash flow was positive, and thus reduced the government's reported budget deficit in that year, so the signals are not quite what you might want over the long term.

But let me turn now to PBGC's long-term financial challenges. PBGC's largest insurance program, the Single Employer Program, has been hammered by claims resulting from employer bankruptcies and the associated terminations of large underfunded plans. Indeed GAO put this program on its high-risk list in 2003, and by 2004, PBGC's net deficit for this program exceeded $23 billion.

Since then, economic conditions favorable to employers and plans have helped to reduce PBGC's net deficit, and passage of the Pen-

sion Protection Act of 2006 has the potential to strengthen planned funding in the future. However, more recent economic events may affect employers and their pension plans negatively, and could in turn have an impact on PBGC.

In addition, PBGC has recently altered its investment policies to improve returns, but our work suggests that the higher risk associated with such a policy needs more attention. Hence, we believe PBGC's financial challenges remain.

Finally, although my written statement also discusses several management issues, with time constraints I will focus on the most important of these, which are our government's concerns.

PBGC's board, as you heard, is comprised of three cabinet secretaries, and it has limited time and resources to devote to providing policy direction and oversight that would be needed for this growing corporation.

The size and composition of the board doesn't meet corporate governance guidelines, and further we found that no other government corporation has a board as small as PBGC's.

Although the board has recently approved a set of new by-laws, some critical decisions and processes go undocumented, including approval and oversight of the various changes in investment policies made over the years.

Further, the composition of the board assures that the entire board will turn over along with the PBGC director when a new administration takes office in January.

Last year, we recommended that the Congress restructure the PBGC board to expand membership, stagger terms, and diversify expertise.

In conclusion, PBGC acts as a crucial support for American's retirement income security. It began as a relatively small benefit insurance agency in the seventies, but today manages billions in assets, pays benefits to more than a million Americans, and is still growing.

It is unclear what today's economic turmoil will mean for PBGC in the future, and how effective recent legislative changes will be in protecting the Corporation.

Although improving the governance and oversight of PBGC will not by itself solve these problems, such actions could be critical to helping PBGC manage them as they arise, and we urge Congress to consider legislating these needed improvements.

That concludes my statement, Mr. Chairman. I await your questions.

[The prepared statement of Ms. Bovbjerg follows:]

Statement of Barbara D. Bovbjerg, Director, Education, Workforce, and Income Security, United States Government Accountability Office

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

For Release on Delivery
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PENSION BENEFIT GUARANTY CORPORATION

Improvements Needed to Address Financial and Management Challenges

Statement of Barbara D. Bovbjerg, Director
Education, Workforce, and Income Security

GAO
Accountability * Integrity * Reliability

GAO-08-1162T

September 24, 2008

PENSION BENEFIT GUARANTY CORPORATION

Improvements Needed to Address Financial and Management Challenges

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Highlights

Highlights of GAO-08-1162T, a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

The Pension Benefit Guaranty Corporation (PBGC) insures the retirement future of nearly 44 million people in more than 30,000 private-sector defined benefit pension plans.

In July 2003, GAO designated PBGC's single-employer pension insurance program—its largest insurance program—as "high risk," including it on GAO's list of major programs that need urgent attention and transformation. The program remains on the list today with a projected financial deficit of just over $13 billion, as of September 2007.

Because Congress exercises oversight of PBGC, GAO was asked to testify today on 1) the critical role PBGC plays in protecting the pension benefits of workers and how PBGC is funded, 2) the financial challenges facing PBGC, and 3) the PBGC's governance, oversight and management challenges.

To address these objectives, we are relying on our reports from the last several years that, as part of our designation of PBGC's single-employer program as high-risk, explored the financial and management challenges facing the agency. GAO has made a number of recommendations and matters for Congressional consideration in these past reports. PBGC generally agreed with these past recommendations and is implementing many of them. No new recommendations are being made as part of this testimony.

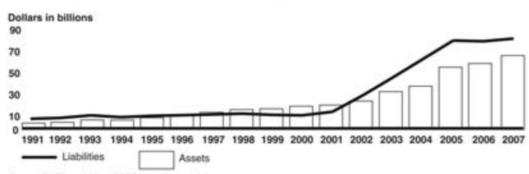
To view the full product, including the scope and methodology, click on GAO-08-1162T. For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

What GAO Found

PBGC administers the current or future pension benefits for a growing number of participants of plans that have been taken over by the agency—from 500,000 in fiscal year 2000 to 1.3 million participants in fiscal year 2007. PBGC is financed by insurance premiums set by Congress and paid by sponsors of defined benefit (DB) plans, investment income, assets from pension plans trusteed by PBGC, and recoveries from the companies formerly responsible for those trusteed plans; PBGC receives no funds from general revenues. The treatment of PBGC in the federal budget is complicated by the use of two accounts—an on–budget revolving fund and a non-budgetary trust fund. Ultimately this budget treatment can be confusing–especially in the short-term—as on-budget gains may be offset by long-term liabilities that are not reported to on-budget accounts.

PBGC's single-employer program faces financial challenges from a history of weak plan funding rules that left it susceptible to claims from sponsors of large, severely underfunded pension plans. PBGC had seen recent improvements to its net financial position due to generally better economic conditions and from statutory changes that raised premiums and took measures designed to strengthen plan funding and PBGC guarantees. However, certain improvements have only just begun phasing-in and the changes did not completely address a number of the risks that PBGC faces going forward. Further, PBGC just began implementing a new investment policy that, while offering the potential for higher returns, also adds significant variability and risk to the assets it manages. Also, changing economic conditions could further expose PBGC to future claims.

PBGC Assets and Liabilities, Fiscal Year 1991 to 2007



Source: GAO's analysis of PBGC annual report data.

Improvements are needed to PBGC's governance structure and to its strategic approach to program management. PBGC's three member board of directors is limited in its ability to provide policy direction and oversight. PBGC may also be exposed to challenges as the board, its representatives, and the director will likely change with the upcoming presidential transition in January. In addition, PBGC lacks a strategic approach to its acquisition and human capital management needs. Three-quarters of PBGC's administrative budget is spent on contractors, yet PBGC's strategic planning generally does not recognize contracting as a major aspect of PBGC activities.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the financial and operational challenges facing the Pension Benefit Guaranty Corporation (PBGC). PBGC operates two pension insurance programs that protect the retirement income of nearly 44 million workers in over 30,000 private-sector defined benefit pension plans. In July 2003, GAO designated PBGC's single-employer pension insurance program—its largest insurance program—as "high risk," including it on GAO's list of major programs that need urgent attention and transformation.[1] The program remains on the list today with a projected financial deficit of just over $13 billion, as of September 2007.

PBGC was created as a self-financing, wholly owned government corporation by the Employee Retirement Income Security Act of 1974 (ERISA).[2] PBGC is managed by a presidentially-appointed, Senate-confirmed director, and governed by a three-member board of directors, consisting of the Secretaries of the Treasury, Labor, and Commerce, that is charged with providing policy direction and oversight of PBGC's finances and operations. PBGC's primary responsibilities are to collect premiums from the sponsors of defined benefit plans to insure against default and to assume administration of underfunded plans that terminate. In the event of a plan default, PBGC assumes control of plan assets (including amounts due and payable from the plan sponsor), calculates benefit amounts due plan participants, and pays recipients as benefits are due.

My statement is based on our prior work assessing PBGC's long-term financial challenges, and several reports that we have published over the past two years on PBGC governance and management. Specifically, my statement will discuss the (1) critical role PBGC plays in protecting the pension benefits of workers and how PBGC is funded, (2) financial challenges facing PBGC, and (3) PBGC's governance, oversight and management challenges.

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[1]GAO, *Pension Benefit Guaranty Corporation Single-Employer Insurance Program: Long-Term Vulnerabilities Warrant "High Risk" Designation*, GAO-03-1050SP (Washington, D.C.: July 23, 2003).

In summary, PBGC administers the current or future pension benefits for a growing number of participants of plans that have been taken over by the agency—from 500,000 in fiscal year 2000 to 1.3 million participants in fiscal year 2007. PBGC is financed by insurance premiums set by Congress and paid by sponsors of defined benefit (DB) plans,[3] investment income, assets from pension plans trusteed by PBGC, and recoveries from the companies formerly responsible for those trusteed plans; PBGC receives no funds from general revenues. The treatment of PBGC in the federal budget is complicated by the use of two accounts—an on–budget revolving fund and a non-budgetary trust fund. This budget treatment can be confusing—especially in the short-term—as on-budget gains may be offset by long-term liabilities that are not reported to on-budget accounts.

PBGC's insurance programs, and specifically the single-employer program, face financial challenges from a history of weak plan funding rules that left it susceptible to claims from sponsors of large, severely underfunded pension plans. We designated PBGC's single-employer insurance program as "high risk" in 2003, because of its longstanding financial challenges. PBGC had seen recent improvements to its net financial position due to generally better economic conditions and from statutory changes that raised premiums and took measures designed to strengthen plan funding and PBGC guarantees. However, certain improvements have only just begun phasing-in and the changes did not completely address a number of the risks that PBGC faces going forward. Further, PBGC just began implementing a new investment policy that, while offering the potential for higher returns, also adds significant variability and risk to the assets it manages.

Improvements are needed to PBGC's governance structure, to oversight of the corporation, and to its strategic approach to program management. PBGC's three-member board of directors is limited in its ability to provide policy direction and oversight. The three cabinet secretaries who comprise the board have numerous other responsibilities, and are unable to dedicate consistent and comprehensive attention to PBGC. With only 3 members, PBGC's board may not be large enough to include the knowledge needed

[3]Employers may voluntarily sponsor DB plans, defined contribution (DC) plans, or both for their employees. DB plans promise to provide a benefit that is generally based on a formula that typically includes an employee's salary and years of service. Under a DC plan, such as a 401(k) plan, employees have individual accounts to which the employee, employer, or both make contributions, and benefits are based on contributions along with investment returns (gains and losses) on the accounts.

to direct and oversee PBGC. According to corporate governance guidelines, the board of directors should be large enough to provide the necessary skill sets, but also small enough to promote cohesion, flexibility, and effective participation. PBGC may also be exposed to challenges as the board, its representatives, and the director will likely change with the upcoming presidential transition in January, limiting the board's institutional knowledge of the corporation. In addition, we found that PBGC lacks a strategic approach to its acquisition and human capital management needs. Although three-quarters of PBGC's administrative budget is spent on contractors, PBGC's strategic planning generally does not recognize contracting as a major aspect of PBGC activities. PBGC also lacks formal, comprehensive human capital policies, programs and practices and does not routinely target workforce data to understand its current and future workforce needs.

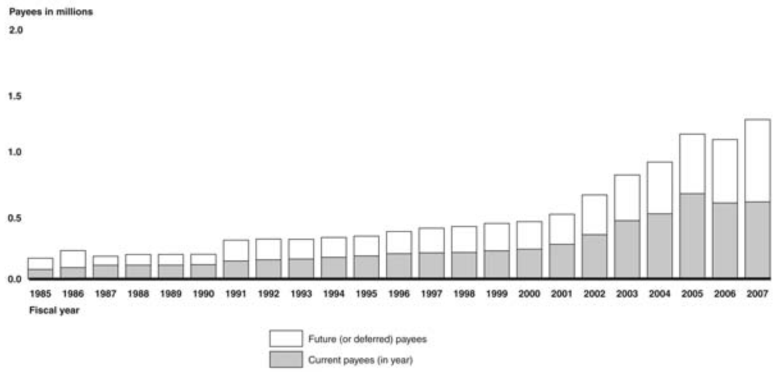
PBGC Guarantees Pension Benefits for Millions and is Funded by Premiums and Assets of Terminated Plans

PBGC plays a critical role in protecting the pension benefits of private sector workers—it is responsible for administering current or future pension benefit payments to just over 1.3 million plan participants. Its budget operations flow through two accounts, one that appears in the federal budget and one that does not. PBGC's budget can be confusing, especially in the short-term, as apparent federal budget gains may be offset by long-term liabilities that are not reported to on-budget accounts.

PBGC Plays a Critical Role in Protecting Pension Benefits

PBGC plays a critical role in protecting the pension benefits of private sector workers. PBGC administers current or future pension benefit payments to a growing number of plan participants, from just under one-half million in fiscal year 2000 to 1.3 million in fiscal year 2007. Figure 1 shows the breakdown of recipients of benefit payments from PBGC's single-insurance program.

Figure 1: Number of Payees Receiving Current or Future Single-Employer Program Benefits from PBGC, fiscal year 1985-2007



Source: PBGC's Pension Insurance Data Book 2006 (table S-20), PBGC's Pension Insurance Data Book 2001 (table S-3), and preliminary data.

PBGC benefits are insured up to certain limits—up to $51,750 per year (about $4300 per month) for participants aged 65, with lower benefits for younger participants.[4] While the actual annual benefits paid to participants are not adjusted for inflation, the initial maximum levels are set by law and are indexed for inflation. Covered benefits include pension benefits accrued at normal retirement age, most early retirement benefits, and survivor and disability benefits. PBGC pays these benefits when a plan is terminated and the plan has insufficient assets to pay all benefits accrued under the plan up to the date of plan termination. In 2006, PBGC paid over 622,000 people a median benefit of about $296 per month.

The vast majority of the participants in PBGC-trusteed plans receive all the benefits they were promised by their plan. Benefits for some participants may be reduced if 1) their benefits exceed PBGC's maximum guarantee

[4]The limit is reduced if the benefit is not paid as a single-life annuity. For example, the limit is reduced if the benefit is paid as a joint-and-survivor annuity.

limit, 2) a benefit increase occurred (or became payable due to a plant shutdown) within five years of the plan's termination, or 3) a part of their benefit is a supplemental benefit.[5] In addition to paying guaranteed benefits, PBGC may pay certain non-guaranteed benefits in limited circumstances involving asset recoveries from employers.

PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, investment income of assets from pension plans trusteed by PBGC ($4.8 billion in investment income from $68.4 billion in assets for its combined programs in 2007) and recoveries from the companies formerly responsible for the plans. Under current law, other than statutory authority to borrow up to $100 million from the Treasury Department (sometimes referred to as a $100 million line of credit), no substantial source of funds is available to PBGC if it runs out of money.[6] In the event that PBGC were to exhaust all of its holdings, benefit payments would have to be drastically cut unless Congress were to take positive action to provide support.

In 2007, PBGC received over $1.5 billion in premium income. An insured plan in the single employer program was required to pay PBGC a yearly premium of $31 per participant for pension benefit insurance coverage in 2007. This per-participant premium rate is adjusted annually to wage inflation. Plans that are underfunded as specified by ERISA must pay PBGC an additional premium of $9 per $1,000 of underfunding. Some terminating plans have to pay an "exit" premium of $1,250 per participant per year for three years if they undergo a distress or PBGC-initiated plan termination on or after January 1, 2006.

PBGC also insures multiemployer defined benefit pensions through its multiemployer program. Multiemployer plans are established through collective bargaining agreements involving two or more unrelated employers and are common in industries such as construction, trucking, mining, the hotel trades, and segments of the grocery business. The

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[5]Additional guarantee restrictions apply if the plan's termination date occurred while the employer was in a bankruptcy proceeding that began on or after September 16, 2006, or if the plan is a commercial passenger airline plan or airline catering plan that elected the 17-year funding relief under the Pension Protection Act of 2006, Pub. L. No. 109-280, § 402, 120 Stat. 780, 922-28 (Aug. 17, 2006)(reprinted in 26 U.S.C. § 430 note).

[6]PBGC has used this "line of credit" only once—to cover the agency's startup costs—and quickly repaid.

multiemployer program is far smaller than the PBGC single employer program, insuring about 10 million participants in about 1,530 plans. Like the single employer program, PBGC collects premiums from sponsoring employers and insures multiemployer participant benefits up to a limit, although both the level of premiums and the maximum insured limit are far lower than those for the single employer program.[7] Further, unlike the single-employer program, a multiemployer plan termination does not trigger the PBGC benefit guarantee. A terminated multiemployer plan continues to pay full plan benefits so long as it has sufficient assets to do so.[8]

PBGC's Budget Only Partly Flows through the Federal Government

The treatment of PBGC in the federal budget is complicated by the use of two accounts—an on–budget revolving fund and a non-budgetary trust fund. Some activities flow through the federal budget and other activities are outside the federal budget. Not only is PBGC's budget structure complex, it can also result in confusing signals about the financial health of PBGC and create unintended policy incentives.

PBGC's receipts and disbursements are required by law to be included in the federal budget.[9] These cash flows are reported in the budget in a single revolving fund account.[10] The cash flows include premiums paid, interest income on federal securities, benefit payments, administrative expenses, and reimbursements from PBGC's non-budgetary trust fund. The non-

[7]Multiemployer DB plans must pay PBGC a yearly premium of $8.00 per participant for pension benefit insurance coverage in 2007. Like the single employer program, the PBGC multiemployer premium rate is adjusted annually to changes in the national average wage index and then rounded to the nearest whole dollar. However, there is no underfunding or exit premium for multiemployer plans. For multiemployer plan participants, the maximum insured benefit is about $12,870 for a participant with 30 years of service. Unlike the single employer program, the maximum insurable benefit limit for multiemployer participants is not indexed to wage inflation and has not changed since December 2000.

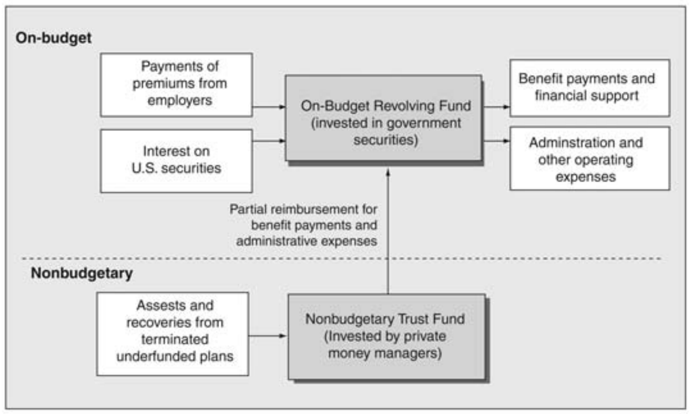
[8]PBGC permits multiemployer plans that cannot pay full benefits to pay reduced benefits equal to the PBGC guarantee. For plans that become insolvent, PBGC will typically loan the plan an amount necessary to pay guaranteed benefits and administrative expenses. In the past, few plans receiving financial assistance from PBGC have recovered sufficiently to repay all the monies lent to them and PBGC typically does not expect the loans to be repaid. An allowance has been established on PBGC's financial records to account for financial assistance that is not expected to be repaid.

[9]29 U.S.C. § 1302(g)(2).

[10]29 U.S.C. § 1305. Although technically there are seven revolving funds, PBGC uses only three, and their activities are combined into one fund for reporting purposes.

budgetary trust fund includes assets obtained from terminated plans and is managed by private money-managers. Because the trust fund is a non-budgetary account, the transfer of assets from terminated plans to PBGC is not considered a receipt to the government. Likewise, the liabilities PBGC incurs when it takes over an underfunded plan or other changes in PBGC's assets and liabilities are not reflected in the budget. Figure 2 provides an overview of PBGC's budgetary and non-budgetary cash flows.

Figure 2: PBGC's cash flows



Source: Congressional Budget Office.

When an insured pension plan is terminated, assets are transferred to PBGC's non-budgetary trust fund. Neither these assets nor the benefit liabilities appear on the federal balance sheet and PBGC's net loss is not recorded in the federal government's income statement. Assets in the non-budgetary trust fund are commingled and no longer identified with particular plans. PBGC has broad authority to oversee and administer pension assets held in its trust fund and is free to invest and expend the funds as if it were a private fiduciary of the trust fund's holdings. PBGC can invest the assets in whatever way it chooses, as long as it acts in the best financial interest of beneficiaries.

In addition to the non-budgetary trust fund, PBGC has an on-budget revolving fund. Premium income and transfers from the trust fund for both benefit payments and administrative expenses are deposited to the

revolving funds as offsetting collections (that is, offsets to outlays). Unlike the trust fund, the revolving fund appears on the federal government's balance sheet and provides PBGC with permanent spending authority to carry out its activities. In years that premium income and trust fund reimbursements exceed benefit payment and administrative costs, the revolving fund would show negative outlays, thus improving the overall fiscal balance of the federal government. Any funds that are not used to pay benefits or expenses are considered unobligated balances and are available for expenditure in the next year. By law, unobligated funds in the revolving fund must be held in Treasury securities and earn interest income.

PBGC transfers funds from the non-budgetary trust fund to its on-budget revolving fund to pay a portion of retirement annuities and certain administrative costs. Such transfers are referred to as reimbursements and are recorded as offsetting collections in the budget. Generally, the proportion of benefit payments that is reimbursed from the trust fund depends on the aggregate funding level of the plans that PBGC has taken over and is adjusted periodically. In other words, if the average funding ratio of all plans taken over by PBGC is 50 percent, then half of all benefit payments originate from the non-budgetary trust fund. In addition to financing benefits, trust fund assets are also transferred to the revolving fund to pay for PBGC's administrative expenses related to terminations. PBGC's other administrative expenses are paid directly from the revolving fund.[11]

Insurance programs with long-term commitments, such as PBGC, may distort the budget's fiscal balance by looking like revenue generators in years that premium collections exceed benefit payments and administrative expenses because the programs' long-term expected costs are not reported. For example, in 2004 when PBGC's losses measured on an accrual basis ballooned and its deficit grew from \$11 billion to \$23 billion, PBGC's cash flow reported in the budget was positive and reduced the federal government's budget deficit.

[11]Prior to 2004, administrative expenses not directly related to terminations were paid from appropriations, which were then reimbursed by the revolving fund. Legislation enacted in 2003 eliminated the distinction between moneys covering administrative expenses related to terminations and those unrelated to terminations; now, all administrative spending is considered direct spending from the revolving fund.

GAO has reported previously that the cash-based federal budget, which focuses on annual cash flows, does not adequately reflect the cost of pension and other insurance programs.[12] Generally, cost is only recognized in the budget when claims are paid rather than when the commitment is made. Benefit payments of terminated plans assumed by PBGC may not be made for years, even decades, because plan participants generally are not eligible to receive pension benefits until they reach age 65. Once eligible, beneficiaries then receive benefit payments for the rest of their lives. As a result, there can be years in which PBGC's current cash collections exceed current cash payments, regardless of the expected long-term cost to the government.

PBGC Continues to Face Financial Challenges

PBGC's single-employer program faces financial challenges both from past claims resulting from bankruptcies and plan termination, which have been concentrated in a few industrial sectors, and structural problems such as weak plan funding rules and a premium structure that does not fully reflect the various risks posed by plans. Because of these financial challenges, GAO designated the single-employer program as "high risk" in 2003, and it remains so today. PBGC has seen recent improvements to its net financial position and recent legislative changes have raised premiums, changed certain plan funding rules and limited PBGC guarantees. However, the legislation has only been recently implemented and it did not completely address a number of the risks that PBGC faces going forward. Further, PBGC has recently implemented a new investment policy which adds significant variability and risk to the assets it manages.

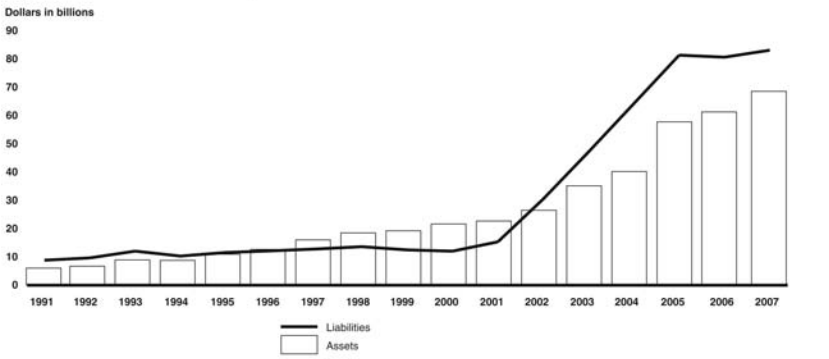
PBGC's net deficit for the single-employer program, which is currently $13.1 billion, reached a peak of $23.3 billion (or $23.5 billion for both insurance programs combined) in 2004 largely as a result of a number of realized and probable claims that occurred during that year.[13] See figure 3 for the difference between PBGC assets and liabilities for both insurance programs from 1991 to 2007. GAO has generally focused its work on the single-employer pension insurance program with respect to PBGC's

[12]GAO, *Budget Issues: Budgeting for Federal Insurance Programs,* GAO/AIMD-97-16 (Washington D.C.: Sept. 30, 1997).

[13]Claims are the net cost of terminating a pension plan—the gap between its assets and its liabilities.

overall financial challenges. This is because the single-employer program represents nearly all of the assets and liabilities held by PBGC.[14]

Figure 3: PBGC Assets and Liabilities, Fiscal Year 1991 to 2007



Source: GAO's analysis of PBGC annual report data.

Note: Figure includes assets and liabilities of single-employer program and multi-employer program. The single-employer program accounts for over 95 percent of all assets and liabilities within each year over this period.

The assets and liabilities that PBGC accumulates from taking over, or "trusteeing," plans has increased rapidly over the last 5 years or so. This is largely due to the termination, typically through bankruptcies, of a number

[14]As noted earlier, the multiemployer program is a much smaller program. For example, the current liabilities of the multiemployer program represent less than 3 percent of PBGC's total liabilities for both its insurance programs. Despite its smaller size, we have reported on the unique financial challenges that the program faces and we will continue to monitor developments. See GAO, *Private Pensions: Multiemployer Plans Face Short- and Long-Term Challenges,* GAO-04-423 (Washington, D.C.: March 26, 2004).

of very large, underfunded plan sponsors.[15] In fact, eight of the top 10 largest firms that have presented claims to PBGC did so from 2002 to 2005. (See table 1).

Table 1: Top 10 Firms Presenting Claims (1975-2006) Single-employer Program

Top 10 firms	Number of plans	Fiscal year(s) of plan terminations(s)	Claims (by firm)	Vested participants	Claim per vested participant	Average percent of total claims (1975-2006)
1. United Airlines	4	2005	$7,484,348,482	122,541	$61,076	22.9%
2. Bethlehem Steel	1	2003	3,654,380,116	97,015	37,668	11.2%
3. US Airways	4	2003, 2005	2,690,222,805	59,778	45,004	8.2%
4. LTV Steel	6	2002, 2003, 2004	2,136,698,831	83,879	25,474	6.5%
5. National Steel	7	2003	1,275,628,286	35,580	35,852	3.9%
6. Pan American Air	3	1991, 1992	841,082,434	37,485	22,438	2.6%
7. Weirton Steel	1	2004	690,181,783	9,196	75,052	2.1%
8. Trans World Airlines	2	2001	668,377,106	34,257	19,511	2.0%
9. Kaiser Aluminum	3	2004	600,009,879	17,591	34,109	1.8%
10. Kemper Insurance	2	2005	568,417,151	12,221	46,512	1.7%
Top 10 total	**33**	**-**	**$20,609,346,871**	**509,543**	**$40,447**	**63.2%**
All other total	**3,640**	**-**	**12,017,433,400**	**1,194,479**	**10,061**	**36.8%**
Total	**3,673**	**-**	**$32,626,780,271**	**1,704,022**	**$19,147**	**100.0%**

Source: PBGC's Pension Insurance Data Book 2006 (table S-31).

These top 10 claims alone currently account for nearly two-thirds of all of PBGC's claims and are concentrated among firms representing the steel and airline industries. Overall, these industries account for about three-

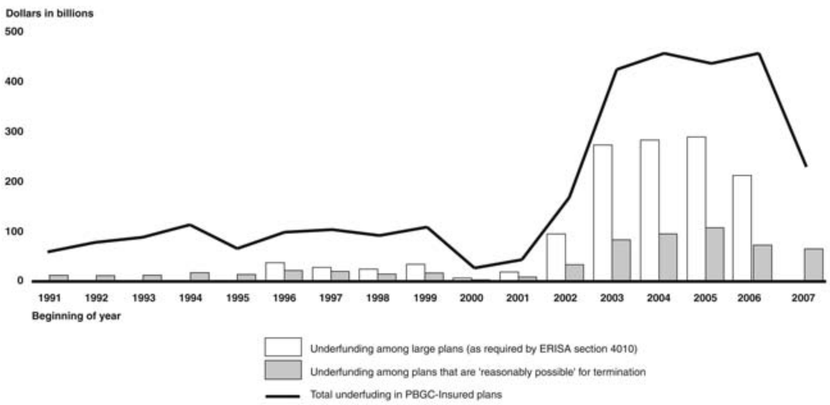
[15] The termination of a fully funded DB plan is called a standard termination. Plan sponsors may terminate fully funded plans by purchasing a group annuity contract from an insurance company, under which the insurance company agrees to pay all accrued benefits, or by paying lump-sum benefits to participants if permissible. The termination of an underfunded plan, termed a distress termination, is allowed if the plan sponsor requests the termination and the sponsor satisfies other criteria. Alternatively, PBGC may initiate an "involuntary" termination. PBGC may institute proceedings to terminate a plan if the plan has not met the minimum funding standard, the plan will be unable to pay benefits when due, a reportable event has occurred, or the possible long-run loss to PBGC with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated. See 29 U.S.C. § 1342(a).

quarters of PBGC's total claims and total single-employer benefit payments in 2006.

While the claims presented by the steel and airline industries were due in some part to restructuring and competitive pressures in those industries, it is important to recognize other economic and regulatory factors affected PBGC and DB plan sponsors as a whole. For example, when we reported on airline pension plan underfunding in late 2004 we noted that several problems contributed to the broad underfunding of DB plans.[16] These problems included cyclical factors like the so called "perfect storm" of key economic conditions, in which declines in stock prices lowered the value of pension assets used to pay benefits, while at the same time a decline in interest rates inflated the value of pension liabilities. The combined "bottom line" result was that many plans were underfunded at the time and had insufficient resources to pay all of their future promised benefits. Figure 4 shows the underfunding of PBGC's single-employer plans from 1991 to 2007.

[16]GAO, *Private Pensions: Airline Plans' Underfunding Illustrates Broader Problems with the Defined Benefit Pension System*, GAO-05-108T (Washington, D.C.: Oct. 7, 2004)

Figure 4. Underfunding of PBGC Single-Employer Insured Plans Using Alternative Measures, 1991-2007



Source: PBGC's Pension Insurance Data Book 2006 (table S-47), 2007 Annual Management Report, and preliminary data.

Note: 'Underfunding among large plans' is from data obtained under Section 4010 of ERISA, which, prior to the Pension Protecton Act of 2006 (PPA) required that companies annually provide PBGC with information on their underfunded plans if the firm's aggregate underfunding exceeds $50 million or there is an outstanding lien for missed contributions exceeding $1 million or an outstanding funding waiver of more than $1 million and underfunding is reported based on an estimate of vested benefits. Section 4010 data was not required or reported prior to 1996, and is not yet reported for 2007 due to changes from PPA. 'Underfunding among plans that are reasonably possible for termination' is among plan sponsors with less than investment-grade bond ratings and is based on an estimate of vested benefits. 'Total underfunding in PBGC-insured plans' includes the universe of PBGC single-employer insured plans and estimated total liabilities are based on all plan liabilities, whether vested or not.

In 2003, GAO designated PBGC's single-employer program as high-risk, or as a program that needs urgent Congressional attention and agency action. We specifically noted PBGC's prior-year net deficit as well as the risk of the termination among large, underfunded pension plans, as reasons for

the programs high-risk designation.[17] As part of our monitoring of PBGC as a high-risk agency we have highlighted additional challenges faced by the single-employer program. Among these concerns were the serious weaknesses that existed with respect to plan funding rules[18] and that PBGC's premium structure and guarantees needed to be re-examined to better reflect the risk posed by various plans.[19] Additionally the number of single-employer insured DB plans has been rapidly declining, and, among the plans still in operation, many have frozen benefits to some or all participants. [20] Additionally the prevalence of plans that are closed to new participants seems to imply that PBGC is likely to see a decline in insured participants, especially as insured participants seem increasingly likely to be retired (as opposed to active or current) workers.

There have been a number of developments with respect to PBGC's situation since we issued our most recent high risk updates in 2005 and 2007. At least until fairly recently, key economic conditions have been generally favorable for DB plan sponsors and plan funding has generally improved. In addition, major pension legislation was enacted which addressed many of the concerns articulated in our previous reports and testimonies on PBGC's financial condition. The Deficit Reduction Act of 2005 (DRA) was signed in to law on February 8, 2006 and included

[17]The condition of the single-employer program has been a longstanding concern of both the Congress and GAO. In 1990, as part of our effort to call attention to high-risk areas in the federal government, we noted that weaknesses in the single-employer insurance program's financial condition threatened PBGC's long-term viability. We stated that minimum funding rules still did not ensure that plan sponsors would contribute enough for terminating plans to have sufficient assets to cover all promised benefits. In 1992, we also reported that PBGC had weaknesses in its internal controls and financial systems that placed the entire agency, and not just the single employer program, at risk. Three years later, we reported that legislation enacted in 1994 had strengthened PBGC's program weaknesses and that we believed improvements had been significant enough for us to remove the agency's high-risk designation—though we continued to monitor PBGC's situation.

[18]GAO, *Private Pensions: Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules,* GAO-05-294 (Washington, D.C.: May 31, 2005)

[19]GAO, *Pension Benefit Guaranty Corporation: Single-Employer Pension Insurance Program Faces Significant Long-Term Risks,* GAO-04-90 (Washington, D.C.: Oct. 29, 2003)

[20]A plan freeze is an amendment to the plan to limit some or all future pension accruals for some or all plan participants. See GAO, *Defined Benefit Pensions: Plan Freezes Affect Millions of Participants and Pose Retirement Income Challenges,* GAO-08-817 (Washington, D.C.: July 21, 2008) and GAO, *Private Pensions: Timely and Accurate Information Is Needed to Identify and Track Frozen Defined Benefit Plans,* GAO-04-200R (Washington, D.C.: Dec. 17, 2003).

provisions to raise flat-rate premiums[21] and created a new, temporary premium for certain terminated single-employer plans.[22] Later that year the Pension Protection Act of 2006 (PPA) was signed into law and included a number of provisions aimed at improving plan funding and PBGC finances. However, PPA did not fully close plan funding gaps, did not adjust premiums in a way that fully reflected risk from financially distressed sponsors and provided special relief to plan sponsors in troubled industries, particularly those in the airline industries. PBGC's net financial position improved from 2005 to 2006 because some very large plans that were previously classified as probable terminations were reclassified to a reasonably possible designation as a result of the relief granted to troubled industries. Since this provision has only been implemented for a few years, it is still too early to determine how much risk of new claims these reclassified plans still represent to PBGC. As many of the provisions in PPA are still phasing-in, we will continue to monitor the status of the single-employer program with respect to PPA and will be updating our high risk series in early 2009.

GAO recently reported on a newly developing financial challenge facing PBGC due to the recent change to its investment policy.[23] While the investment policy adopted in 2008 aims to reduce PBGC's $14 billion deficit by investing in assets with a greater expected return, GAO found that the new allocation will likely carry more risk than acknowledged by PBGC's analysis. According to PBGC the new allocation will be sufficiently diversified to mitigate the expected risks associated with the higher expected return. They also asserted that it should involve less risk than the previous policy. However, GAO's assessment found that, although returns are indeed likely to grow with the new allocation, the risks are

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[21]The flat-rate premium is a per-participant premium that plans pay to PBGC each year. In 2008, the rate for the flat premium is $33 per participant in insured single-employer plans. For multiemployer plans the flat rate premium is $9.00 per participant. These rates are adjusted annually by an average-national-wage index.

[22]Pub. L. No. 109-171, § 8101, 120 Stat. 4, 180-83 (codified at 29 U.S.C. § 1306). The legislation created a new premium for sponsors of plans that are terminated on an involuntary or distressed termination basis. The required payment is $1,250 per plan participant, per year, for three years after the termination. For sponsors whose plans were terminated while the program was being reorganized under chapter 11 of the bankruptcy code, the premium would be levied after the sponsor emerges from bankruptcy. Under DRA the premium would not apply to firms that are liquidated by a bankruptcy court or to terminations after December 2010.

[23]GAO, *PBGC Assets: Implementation of New Investment Policy Will Need Stronger Board Oversight,* GAO-08-667 (Washington, D.C.: July 17, 2008)

likely higher as well. Although it is important that the PBGC consider ways to optimize its portfolio, including higher return and diversification strategies, the agency faces unique challenges, such as PBGC's need for access to cash in the short-term to pay benefits, which could further increase the risks it faces with any investment strategy that allocates significant portions of the portfolio to volatile or illiquid assets.

Improvements Needed to PBGC's Governance, Oversight and Management

Improvements are needed to PBGC's governance structure, to oversight of the corporation, and to its strategic approach to program management. PBGC's three member board of directors is limited in its ability to provide policy direction and oversight. According to corporate governance guidelines, the board of directors should be large enough to provide the necessary skill sets, but also small enough to promote cohesion, flexibility, and effective participation. PBGC may also be exposed to challenges as the board, its representatives, and the director will likely change with the upcoming presidential transition in January, limiting the board's institutional knowledge of the corporation. In addition, Congressional oversight of PBGC in recent years has ranged from formal congressional hearings to the use of its support agencies, such as GAO, the Congressional Budget Office, and the Congressional Research Service. However, unlike some other government corporations, PBGC does not have certain reporting requirements for providing additional information to Congress. Finally, we found that PBGC lacks a strategic approach to its acquisition and human capital management needs.

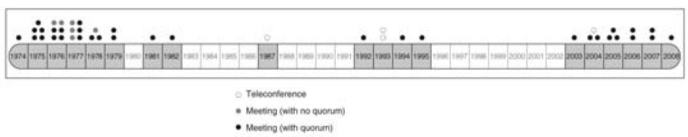
PBGC's Governance Structure Needs Improvement

PBGC's board has limited time and resources to provide policy direction and oversight and had not established comprehensive written procedures and mechanisms to monitor PBGC's operations.[24] PBGC's three-member board, established by ERISA, includes the Secretary of Labor as the Chair of the Board and the Secretaries of Commerce and Treasury. We noted that the board members have designated officials and staff within their respective agencies to conduct much of the work on their behalf and relied mostly on PBGC's management to inform these board members' representatives of pending issues. PBGC's board members have numerous other responsibilities in their roles as cabinet secretaries and have been unable to dedicate consistent and comprehensive attention to PBGC.

[24]GAO, *Pension Benefit Guaranty Corporation: Governance Structure Needs Improvements to Ensure Policy Direction and Oversight*, GAO-07-808 (Washington, D.C.: July 6, 2007).

Since PBGC's inception, the board has met infrequently. In 2003, after several high-profile pension plan terminations, PBGC's board began meeting twice a year (see figure 5). PBGC officials told us that it is a challenge to find a time when all three cabinet secretaries are able to meet, and in several instances the board members' representatives officially met in their place. While the PBGC board is now meeting twice a year, very little time is spent on addressing strategic and operational issues. According to corporate governance guidelines, boards should meet regularly and focus principally on broader issues, such as corporate philosophy and mission, broad policy, strategic management, oversight and monitoring of management, and company performance against business plans.[25] However, our review of the board's recorded minutes found that although some meetings devoted a portion of time to certain strategic and operational issues, such as investment policy, the financial status of PBGC's insurance programs, and outside audit reviews, the board meetings generally only lasted about an hour.

Figure 5: Number of PBGC Board Meetings 1974 to September 2008



Source: GAO analysis of PBGC documents and board meeting minutes.

The size and composition of PBGC's board does not meet corporate governance guidelines. According to corporate governance guidelines published by The Conference Board,[26] corporate boards should be structured so that the composition and skill set of a board is linked to the corporation's particular challenges and strategic vision, and should include a mix of knowledge and expertise targeted to the needs of the corporation. We did not identify any other government corporations with boards as small as at PBGC. Government corporations' boards averaged about 7 members, with one having as many as 15. In addition, PBGC may

[25] Matteo Tonello and Carolyn K. Brancato, *Corporate Governance Handbook, 2007: Legal Standards and Board Practices*, Research Report R-1405-07-RR, The Conference Board (New York, New York: 2007).

[26] *Corporate Governance Handbook, 2007*, Research Report R-1405-07-RR. The Conference Board is a global business membership and research organization that creates and disseminates knowledge about management and the marketplace.

also be exposed to challenges as the board, board members' representatives, and the director will likely change with the upcoming presidential transition in January 2009, limiting the board's institutional knowledge of the corporation.

The recent revision of PBGC's investment policy provides an example of the need for a more active board.[27] We found that PBGC board's 2004 and 2006 investment policy was not fully implemented. While the board assigned responsibility to PBGC for reducing equity holdings to a range of 15 to 25 percent of total investment, by 2008 the policy goal had not been met. Although the PBGC director and staff kept the board apprised of investment performance and asset allocation, we found no indication that the board had approved the deviation from its established policy or expected PBGC to continue to meet policy objectives.

We previously recommended that Congress consider expanding PBGC's board of directors, to appoint additional members who possess knowledge and expertise useful to PBGC's responsibilities and can provide needed attention. Further, dedicating staff that are independent of PBGC's executive management and have relevant pension and financial expertise to solely support the board's policy and oversight activities may be warranted. In response to our finding, PBGC contracted with a consulting firm to identify and review governance models and provide a background report to assist the board in its review of alternative corporate governance structures. The consulting firm's final report describes the advantages and disadvantages of the corporate board structures and governance practices of other government corporations and select private sector companies, and concludes that there are several viable alternatives for PBGC's governance structure and practices.

Along with the board's limited time and resources, we found that the board had not established comprehensive written procedures and mechanisms to monitor PBGC's operations. There were no formal protocols concerning the Inspector General's interactions with the board,[28] and PBGC internal management were not required to routinely report all matters to the board. Even though PBGC used informal communication to inform the board, it could not be certain that it received high quality and

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[27]GAO-08-667.

[28]PBGC's Office of the Inspector General is an independent office within PBGC established under the Inspector General Act (codified, as amended, at 5 U.S.C. appx).

timely information about all significant matters facing the corporation. As a result we recommended that PBGC's board of directors establish formal guidelines that articulate the authorities of the board, Department of Labor, other board members and their respective representatives. In May 2008 PBGC revised its bylaws. As part of its bylaw revision, the board of directors more explicitly defined the role and responsibilities of the director and the corporation's senior officer positions, and outlined the board's responsibilities, which include approval of policy matters significantly affecting the pension insurance program or its stakeholders; approval of the corporation's investment policy; and review of certain management and Inspector General reports.

Congress Has Overseen PBGC in Several Ways and Some other Government Corporations have Additional Reporting Requirements

Since 2002, PBGC officials have testified 20 times before various congressional committees—mostly on broad issues related to the status of the private sector defined benefit pension policy and its effect on PBGC—and, in 2007, the Senate conducted confirmation hearings of PBGC's director. PBGC must annually submit reports to Congress on its prior fiscal year's financial and operational matters, which include information on PBGC's financial statements, internal controls, and compliance with certain laws and regulations.[29] In addition, through its support agencies—GAO, the Congressional Budget Office, and the Congressional Research Service—Congress has also provided oversight and reviewed PBGC. Specifically, Congress has asked GAO to conduct assessments of policy, management, and the financial condition of PBGC. For example, we conducted more than 10 reviews of PBGC over the past 5 years, including assessments related to PBGC's 2005 corporate reorganization and weaknesses in its governance structure, human capital management, and contracting practices. Our work also raised concerns about PBGC's financial condition and the state of the defined benefit industry.

Some government corporations have additional reporting requirements for notifying Congress of significant actions. For example, the Millennium Challenge Corporation is required to formally notify the appropriate congressional committees 15 days prior to the allocation or transfer of

[29]PBGC is required each year to submit to Congress and the President an annual report, which must include the actuarial assumptions and methods PBGC uses to evaluate the expected 5-year operations and status of its pension benefit guaranty funds, and a comparison of its funds' investment returns with a designated index. 29 U.S.C. § 1308.

funds related to the corporation's activities.[30] The Commodity Credit Corporation is subject to a similar requirement.[31] These examples demonstrate how Congress has required additional reporting requirements for certain activities conducted by government corporations. PBGC generally has no requirements to formally notify Congress prior to taking any significant financial or operational actions.

A More Strategic Approach Could Improve Contracting and Human Capital Management at PBGC

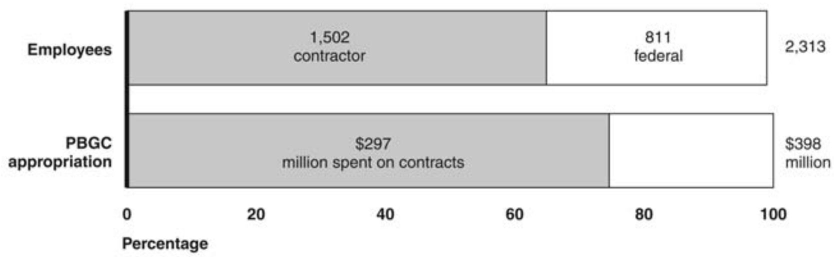
As reported in our recent work on PBGC contracting and human capital management,[32] contracting plays a central role in helping PBGC achieve its mission and address unpredictable workloads. Three-quarters of PBGC's budget was spent on contracts and nearly two-thirds of its personnel are contractors, as shown in figure 6. Since the mid-1980s, PBGC has had contracts covering a wide range of services, including the administration of terminated plans, payment of benefits, customer communication, legal assistance, document management, and information technology. From fiscal year 2000 through 2007, PBGC's contract spending increased steadily along with its overall budget and workload, and its use of contract employees outpaced its hiring of federal employees. As PBGC workload grew due to the significant number of large pension plan terminations, PBGC relied on contractors to supplement its workforce, acknowledging that it has difficulty anticipating workloads due to unpredictable economic conditions.

[30]The Millennium Challenge Corporation is a U.S. government corporation designed to work with foreign countries to reduce global poverty through the promotion of sustainable economic growth. 22 U.S.C. §§ 7701, 7703.

[31]The Commodity Credit Corporation (CCC) is a U.S. government corporation created to stabilize, support, and protect farm income and prices. CCC also helps maintain balanced and adequate supplies of agricultural commodities and aids in their distribution. 15 U.S.C. § 714.

[32]See GAO, *Pension Benefit Guaranty Corporation: Some Steps Have Been Taken to Improve Contracting, but a More Strategic Approach Is Needed,* GAO-08-871 (Washington, D.C.: August 18, 2008) and GAO, *Pension Benefit Guaranty Corporation: A More Strategic Approach Could Improve Human Capital Management,* GAO-08-624 (Washington, D.C.: June 12, 2008).

Figure 6: PBGC Overall Versus Contractor Spending and Personnel, Fiscal Year 2007



Source: PBGC.

In 2000, we recommended that PBGC develop a strategic approach to contracting by conducting a comprehensive review of PBGC's future human capital needs and using this review to better link contracting decisions to PBGC's long-term strategic planning process. PBGC took some initial steps to implement our recommendation, and in August 2008, we reported that PBGC had recently renewed its efforts and drafted a strategic human capital plan.

In addition to drafting a strategic human capital plan, PBGC recently issued its strategic plan; however this plan does not document how the acquisition function supports the agency's missions and goals. Although contracting is essential to PBGC's mission, we found that the Procurement Department is not included in corporate-level strategic planning. Further, PBGC's draft strategic human capital plan acknowledges the need for contractor support, but does not provide detailed plans for how the contract support will be obtained. While PBGC's workload can expand and contract depending on the state of plan terminations, planning documents do not include strategies for managing the fluctuations. Based on these findings, we recommended that PBGC revise its strategic plan to reflect the importance of contracting and to project its vision of future contract use, and ensure that PBGC's procurement department is included in agency-wide strategic planning.

PBGC also needs a more strategic approach for improving human capital management. While PBGC has made progress in its human capital

management approach by taking steps to improve its human capital planning and practices—such as drafting a succession management plan—the corporation still lacks a formal, comprehensive human capital strategy, articulated in a formal human capital plan that includes human capital policies, programs, and practices.[33] PBGC has initiatives for the management of human capital, such as ensuring employees have the skills and competencies needed to support its mission and establishing a performance-based culture within the corporation, and has made some progress toward these goals. However, PBGC has not routinely and systematically targeted and analyzed all necessary workforce data—such as attrition rates, occupational skill mix, and trends—to understand its current and future workforce needs.

PBGC is generally able to hire staff in its key occupations—such as accountants, actuaries, and attorneys—and retain them at rates similar to those of the rest of the federal government. However, PBGC has had some difficulty hiring and retaining staff for specific occupations and positions, including executives and senior financial analysts. PBGC has made use of various human capital flexibilities in which the corporation has discretionary authority to provide direct compensation in certain circumstances to support its recruitment and retention efforts, such as recruitment and retention incentives, superior qualification pay-setting authority, and special pay rates for specific occupations.[34] However, PBGC officials said that they had not recently explored additional flexibilities that required the approval of OPM and OMB to determine whether they would be applicable or appropriate for the corporation.

[33]According to GAO's internal control and management tool, agencies should have control activities, such as policies, procedures, techniques, and mechanisms that help ensure that management's directives to mitigate risk identified during the risk assessment process are carried out. Common categories of control activities include, in part, management of human capital. As part of human capital management, agencies should consider having a coherent overall human capital strategy that encompasses human capital policies, programs, and practices to guide the agency. GAO, *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: Aug. 1, 2001).

[34]Like most federal agencies, PBGC offers a wide range of employee benefits such as health benefits, life insurance benefits, paid leave and holidays, telecommuting or other flexible work schedules, transit subsidies, retirement investment options, flexible health spending accounts, long-term care insurance, student loan repayments, child care and car pool subsidies, and an on-site fitness center—most of which are available to other federal agencies.

Conclusions

PBGC clearly faces many challenges. The impact of PPA is still unclear, but in any case difficult decisions for the future still remain. While PBGC's net financial position has improved along with economic conditions that until recently had been favorable to plan sponsors, we are concerned that such conditions are changing and could leave PBGC exposed to another spate of claims from sponsors of very large severely underfunded plans. The challenges PBGC faces are acutely illustrated by its recent changes to its asset investment policy. The aim of the change to the policy is to reduce the current deficit through greater returns, but, holding all else equal, the potential for greater returns comes with greater risk. This greater risk may or may not be warranted, but the uncertain results of the policy could have important implications for all PBGC stakeholders: plan sponsors, insured participants, insured beneficiaries, as well as the government and ultimately taxpayers.

One thing that is certain: PBGC will continue to require prudent management and diligent oversight going forward. However, PBGC faces challenges with its board structure, which will only become more apparent in the coming months as the board, its representatives, and the corporation's director will likely be entirely replaced by a new president. Without adequate information and preparation, this transition could limit not only the progress made by the current board, its representatives, and director, but may also hinder the corporation's ability to insure and deliver retirement benefits to millions of Americans that rely on the corporation. As this transition highlights, an improved board structure is critical in helping PBGC manage the daunting, and in many ways fundamental, long-term financial challenges it faces, which is why we have recommended the Congress restructure the Board.

Chairman Lewis, Congressman Ramstad, and Members of the Subcommittee, this concludes my prepared statement. I would be happy to respond to any questions you may have.

Contacts and Staff Acknowledgments

For further questions about this statement, please contact Barbara D. Bovbjerg at (202) 512-7215. Individuals making key contributions to this statement include Blake Ainsworth, Charles Jeszeck, Jay McTigue, Charles Ford, Monika Gomez, Craig Winslow, and Susannah Compton.

Appendix I: List of Selected GAO Reports and Testimonies Related to the Pension Benefit Guaranty Corporation

Pension Benefit Guaranty Corporation: Need for Improved Oversight Persists, GAO-08-1062. Washington, D.C.: September 10, 2008.

Pension Benefit Guaranty Corporation: Some Steps Have Been Taken to Improve Contracting, but a More Strategic Approach Is Needed. GAO-08-871. Washington, D.C.: August 18, 2008.

PBGC Assets: Implementation of New Investment Policy Will Need Stronger Board Oversight. GAO-08-667. Washington, D.C.: July 17, 2008.

Pension Benefit Guaranty Corporation: A More Strategic Approach Could Improve Human Capital Management. GAO-08-624. Washington, D.C.: June 12, 2008.

High Risk Series: An Update. GAO-07-310. Washington, D.C.: January 2007.

Pension Benefit Guaranty Corporation: Governance Structure Needs Improvements to Ensure Policy Direction and Oversight. GAO-07-808 Washington, D.C.: July 6, 2007.

PBGC's Legal Support: Improvement Needed to Eliminate Confusion and Ensure Provision of Consistent Advice. GAO-07-757R. Washington, D.C.: May 18, 2007.

Private Pensions: Questions Concerning the Pension Benefit Guaranty Corporation's Practices Regarding Single-Employer Probable Claims. GAO-05-991R. Washington, D.C.: September 9, 2005.

Private Pensions: The Pension Benefit Guaranty Corporation and Long-Term Budgetary Challenges. GAO-05-772T. Washington, D.C.: June 9, 2005.

Private Pensions: Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules. GAO-05-294. Washington, D.C.: May 31, 2005.

Pension Benefit Guaranty Corporation: Single-Employer Pension Insurance Program Faces Significant Long-Term Risks. GAO-04-90. Washington, D.C.: October 29, 2003.

Pension Benefit Guaranty Corporation Single-Employer Insurance Program: Long-Term Vulnerabilities Warrant 'High Risk' Designation. GAO-03-1050SP. Washington, D.C.: July 23, 2003.

Pension Benefit Guaranty Corporation: Statutory Limitation on Administrative Expenses Does Not Provide Meaningful Control. GAO-03-301. Washington, D.C.: February 28, 2003.

GAO Forum on Governance and Accountability: Challenges to Restore Public Confidence in U.S. Corporate Governance and Accountability Systems. GAO-03-419SP. Washington, D.C.: January 2003.

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Chairman LEWIS. Thank you very much for your statement.

At this time we will open the hearing for questions. I ask that each Member follow the 5-minute rule. If the witnesses will respond with short answers, all Members should have the opportunity to ask questions.

Mr. Millard, the last 2 weeks on Wall Street have been unreal, unbelievable. Has PBGC looked at the pension plans held by Fannie, Freddie, and others?

Mr. MILLARD. Yes, sir, we have. It's an interesting situation, because although they are have terrible, terrible times, we have actually looked at some information that we get that's confidential, so I'm not allowed to say what each company has, but I can tell you on an aggregate basis what we've learned, and that is if you look at AIG, Fannie, Freddie, IndyMac, and Lehman, those five, the aggregate underfunding on a termination basis for those five is about $400 million.

Chairman LEWIS. Could you repeat, it's about how much?

Mr. MILLARD. The aggregate underfunding for those five plans is approximately $400 million. However, not all of that $400 million is insured by the PBGC. As you know, PBGC pays up to approximately $51,000 as our maximum guaranteed benefit for a 65-year-old retiree. So, some of the benefits promised are not guaranteed by PBGC. The amount of that $400 million that is guaranteed by the PBGC is approximately $100 million, so there would be about a $305 million loss to the $115,000 participants in those five companies' plans; and the hit to PBGC's deficit, based on the information that we have—and of course that's based on filings and things can change, and it's hard to give any information that's up to date in this marketplace—but as we have estimated it from the information we have, the hit to our deficit from those five would be approximately $100 million.

Chairman LEWIS. Hmm——

Mr. MILLARD. That's if we take them in. It's not at all certain that we will. Right? AIG is not bankrupt now. AIG is in an unusual situation, but it did not file for bankruptcy, so we would not necessarily take AIG's plan. Fannie and Freddie are not bankrupt. We would not necessarily take their plan, or they haven't filed for bankruptcy. So, that is not all clear what will actually happen, but that's the magnitude of the risk that we face there.

Chairman LEWIS. Do you believe that some place along the way or down the road, the taxpayers could be asked to step in and pay for this?

Mr. MILLARD. When you say "pay for this," I mean we are trying to do everything that we can at PBGC to close the deficit over time. The actually "this" that's at issue here, the hit to our deficit would be $100 million; so frankly the actual hit to PBGC's financial status, specifically from those five companies—now understand, we're not talking about the overall financial services sector, we're not talking about the drop in financial stocks and all the defined benefit plans that hold them—I'm trying to give you statistics that are worth relating to you, rather than generalized estimates—so those five companies would hit our deficit to about $100 million. I don't think $100 million is going to be the reason that taxpayers do or do not ultimately have to bail out PBGC's $14 billion deficit.

Chairman LEWIS. Well, in a recent article you stated that PBGC's biggest risk is that it may not able to meet its liability or that it would require a government bailout if the economy got much worse. Is this still the case?

Mr. MILLARD. I believe that the long-term risk to PBGC, particularly under the prior investment policy, was that the implicit assumption was we were going to rely on Congress to bail us out at some point. The prior investment policy basically had as its unstated foundation that we're not going to try to close the deficit, we'll let Congress worry about that. As you know, ERISA states that the government doesn't stand behind our liabilities, so we're trying to improve the possibility that Congress will not have to bail us out in the long run.

But to be clear, in the immediate term we have $68 billion in assets. We pay out a net approximately $2.5 billion a year in benefits, a total of $4 billion a year in benefits. So, we are able to meet those benefits for a number of years to come. We're not a demand institution. People can't show up and say "I want all my benefits right now."

Chairman LEWIS. What is the number one concern at PBGC right now?

Mr. MILLARD. In terms of very hot I would say of course we are concerned about the financial services industry, and we have looked very carefully at what's going on to try to make sure that our managers are managing to the targets that we hired them to manage through our investment managers.

I would say my number one concern is that we have adopted an investment policy that should give us a reasonable chance to get out of our deficit over time. My number one concern is that people would try to change that policy, and change horses in mid-stream. You lose the possibility that this long-term investment policy will pay off. We've taken a very long-term view of the markets. We're not trying to time markets or pick stocks. We're trying to a long term diversified basis increase the likelihood that we will be able to meet our liabilities and that Congress will not be on the hook to bail us out.

Chairman LEWIS. Let me just ask, why are 37,000 people missing their pension benefits?

Mr. MILLARD. You're referring, I believe, to the missing participants. These are people who are already—I don't know if missing's the best word—but the were already missing when we trustee the plan. So, before we get plans, the people who run the plans are already trying to track these people down.

Sometimes there is someone who maybe worked part time or for 2½ years, who didn't stay in touch with the company. Often, they may be dead, but no one can confirm that. So, they come to us, they're already missing. What we do is we try to publicize once a year or so the fact that we have a missing participants program. We make sure that financial journalists are aware of this and occasionally people will write articles about the fact that, hey, you know, if you ever worked for a corporation with a pension plan, you should contact PBGC. It's on our website.

But understand please that once they come to us, they've already been missing for some time and no one has found them in the plans when they were trying to find them.

Chairman LEWIS. What more can be done to find these people to locate them? Is there anything else you can do?

Mr. MILLARD. I think we're being diligent in the following sense. We're not hiring private investigators to track them down, but we try regularly to publicize that this is so, and we do that only after the plan has come to us, and they have already been determined to be missing after the plan has made substantial efforts to track them down.

Chairman LEWIS. Thank you.

Ms. Bovbjerg, let me ask you, what is GAO's greater concern with PBGC? What is your greatest concern with the agency?

Ms. BOVBJERG. We're concerned about the long term and the long-term future defined benefit plans. We reported recently to supplement some work that PBGC has also done on frozen plans that almost half of the employers that we surveyed had at least one plan that they had frozen. While they're paying premiums on these plans, the defined benefit system is shrinking. PBGC is overseeing an area that is only really being concentrated in very large companies and some of the older industries in America that have not been faring very well, and we're concerned about the PBGC's future.

I understand that PBGC does not have many levers at its disposal to alter that future, and that's part of the reason for altering the investment policy, and we understand that.

Chairman LEWIS. Thank you.

Now turning to Ranking Member Ramstad for his questions.

Mr. RAMSTAD. Thank you, Mr. Chairman. I want to thank both the witnesses here today for your testimony.

Dr. Millard, if I may please ask you a couple questions. I noted from PBGC's most recent annual report, as of September 30, 2007 PBGC held about $4.5 billion in asset-based securities, just following up on the line of questioning by the Chairman. Are these, just so I understand, are these mostly mortgage-backed securities?

Mr. MILLARD. Excuse me. PBGC holds approximately 6 percent of its portfolio in mortgage-backed securities, yes.

Mr. RAMSTAD. About 6 percent. Roughly what would the market value of these asset-backed securities be now, given the current situation on Wall Street?

Mr. MILLARD. Well, it's hard for me to say what these would be now, because that's an annual report that's based on September 30th, 2007. To be very clear—and I'm sure you understand this—but we select managers, we don't pick this asset-backed security, this Fannie Mae bond, this IBM bond. We select managers, well-known household names, and they trade in and trade out of certain instruments at certain times. So, I can't tell you what the value of those is, because those may have been bought or sold even a couple of times since September 2007 a year ago.

Mr. RAMSTAD. That accounting is only d1 yearly, once a year?

Mr. MILLARD. Correct. However, right now the holdings—in other words, I can't tell you what happened to those, but our holdings of mortgage-backed securities right now is approximately 9

percent of our portfolio. I would point out, though, that 40 percent of those are in agency securities and 60 percent are almost entirely triple-A-rated.

Mr. RAMSTAD. I want to ask you one last question. Also in reference to your annual report, I see that PBGC invests in derivatives, including futures, forward contracts, credit default swaps, swaption contracts—whatever that means—stock warrants, debt option contracts, and foreign currency—and option contracts. The question is how much of PBGC's investments were in derivative contracts?

Mr. MILLARD. Again, you know, we don't make those contracts, we hire the managers to do them, and we hire managers who——

Mr. RAMSTAD. But you certainly have oversight of those——

Mr. MILLARD. Yes. No, I just wanted to make it clear, we're not sitting at PBGC, trying to write CDS on whatever names we think it needs to be written on.

Mr. RAMSTAD. I understand.

Mr. MILLARD. The number that I can best give you is on credit default swaps—which is what we were able to get the best information on, because I thought you might want to know—we have a $2.8 billion notional value is our current credit default swap exposure, and if all of those went to zero, our expected loss would be about $70 million.

Mr. RAMSTAD. About 70——

Mr. MILLARD. $70 million.

Mr. RAMSTAD. $70 million.

Were Lehman Brothers, Bear Stearns, or AIG the counter-party to any of PBGC's non-exchange-traded derivative contracts?

Mr. MILLARD. AIG was not; Lehman Brothers was. I'm sorry, what was the third one?

Mr. RAMSTAD. Bear Stearns.;

Mr. MILLARD. Hmm, well, Bear Stearns is not. Whether they ever were, I'm sorry, I don't know. I mean I can get you that information. I have who they are currently and it does include Lehman, but it does include AIG.

Mr. RAMSTAD. I was appreciate that.

Finally, Director Millard, are there other counter-parties to your derivative contracts?

Mr. MILLARD. Oh, certainly. I mean other than Lehman Brothers and AIG? I certainly hope so.

Mr. RAMSTAD. Well I mean how many? Let me rephrase that. How many?

Mr. MILLARD. About dozen, maybe approximately a dozen.

Mr. RAMSTAD. Approximately a dozen——

Mr. MILLARD. That also can vary from time to time, depending on the decisions that our managers make.

Mr. RAMSTAD. Very good. Well, thank you again to both the witnesses. I yield back.

Chairman LEWIS. Thank you.

Now I turn to Mr. Kind for his questions.

Mr. KIND. Thank you, Mr. Chairman. Thank you for holding this important hearing and we thank the testimony that we have before us here today.

Mr. Millard, we have a problem. It may not be very comfortable, but I want to give you an opportunity to explain the situation that we're confronted with.

Obviously, we here in Congress and the Committees take our oversight responsibilities extremely seriously, and as a 10-year Member of the Education and Labor Committee, I know we took our oversight responsibilities there very seriously, as we do in this Committee, now that I'm serving on Ways and Means.

But earlier this year, the Ed and Labor Committee issued a subpoena, requesting all the information related to the McKinsey report, a subpoena to my understanding that was basically ignored or brushed off by you and those on your staff. That's the problem.

Obviously you contracted out to have McKinsey do a follow-up report based on GAO's highly critical report of the operations and functions as we know it at PBGC, and then when the Committee of Education and Labor issued the subpoena, they didn't get the response that quite frankly all of us were expecting.

I want to give you an opportunity right now to explain why that subpoena was ignored and why that Committee had to go to McKinsey directly to request the documents that they were seeking.

Mr. MILLARD. To say it was brushed off or ignored I don't think is a fair comment on what occurred. We asserted or engaged in the assertion process of certain executive privilege about deliberative process and draft documents. We made very clear that we were working on finishing that McKinsey report and of course would provide a copy of the McKinsey report to the Ed and Labor Committee when it was finished. I'm not going to try to litigate constitutional issues of privilege—that's really a lawyer's role, not mine—but we did anything but brush it off or ignore it. We tried to cooperatively say what we could show; we explained that we felt that there was a privilege issue; we worked with White House counsel and the Department of Justice to assert or engage in the assertion of executive privilege as appropriate, and as you know, the McKinsey Report has been provided.

Mr. KIND. Director Millard, not to get into an argument with you here, but based on my understanding and the review of your response, there was no constitutional privilege that was asserted. There was some reference to some process or deliberative process which none of us recognize as a valid privilege to exclude the production of documents and the request of information that came from a Congressional Committee.

Now if there's a constitutional privilege you want to assert, then assert it. Then work with Committee staff and our own legal team as far as the basis of that privilege, and maybe something can be worked out. But that clearly wasn't the response that was initially given from PBGC.

Mr. MILLARD. I take issue with your characterization of how we responded. We did discuss privilege issues; we did try to cooperate with the Committee; and the report has been provided.

Of course we take Congress's right to oversight very seriously. Beyond that, for me to try to argue what's constitutional, assertion of privilege, whether you and I agree about deliberative process, I

don't think it's fruitful. I mean by that in that I would be guided by the lawyers.

Mr. KIND. Well, did you or PBGC, anyone on your staff or on the board influence the final report that McKinsey was producing, especially areas that may have been critical of PBGC's operations?

Mr. MILLARD. I don't know what you mean by "influence the report." I mean we had a cooperative process where we all said, "Gee, I think this makes sense, I think this doesn't makes sense." So, in that sense, sure, lots of people influenced the report.

Mr. KIND. Well, again, we're trying to get a clear picture of what's going on here. Obviously, we're talking about billions of dollars and potentially billions of taxpayer dollars that are stake in regards to the investment decision and the management of these important funds that you're responsible for.

You can imaging how irritated we become when we submit what we view as a valid request for information and expecting cooperation from an agency such as yours, only to be stone-walled and not get that, and then in fact have to boot-strap around you and go to the issuing company doing the report, in order to acquire the information that we were seeking to beginning with. Can you see the problem here?

Mr. MILLARD. I understand your point of view very well; but I think you have to understand that the executive branch also has points of view about privilege, and you and I are not going to litigate that issue here I don't think. I'm certainly not going to try to. On a subject like that I'm guided by the attorneys.

Mr. KIND. Now can you provide a little better explanation here today why the investment decisions of PBGC were revamped in February of this year, with no consultation with Congress, no input from us whatsoever; and in fact, again to my understanding, when we had requested that Congressional staff to be able to sit in on those meetings before the decision was made, staff was explicitly excluded from participating. Was there a reason why?

Mr. MILLARD. The board of directors of PBGC is not subject to open meetings. I don't know if your question was more about attendance or the actual policy.

Mr. KIND. Well, take a stab at this. We understood that there was going to be review as far as the investment decisions at PBGC and the meeting was going to be held. We had requested that staff be able to sit in, and find out what was going on. They were excluded. Then you went ahead and made investment decision changes at PBGC with no consultation with Congress at all, without keeping us in the loop.

You know, some of this obviously is a point for the hearing today. But why the lack of any type of lines of communication with the Congress when you're making such potentially important decisions over the investment of these funds?

Mr. MILLARD. I think since 1974 when PBGC was founded, the investment policy has been an issue that is in the purview of the board, and, as I said, the board is not subject to the openings law.

Mr. KIND. So, you find no problem at all for you just to go ahead and make these type of decisions without any line of communication, without any consultation with Congress, and——

Mr. MILLARD. I didn't go ahead and make these decisions. The board along with the board reps along with the advisory Committee, along with a variety of consultants who were involved after an 8-month study, reached a conclusion about how better to enhance the likelihood that PBGC would be able to pay its liabilities over time.

I think that that was a very, very good decision to put the PBGC on a sounder financial footing for the future. I think the executive branch's obligation is to make those kinds of decisions and carry out the task that you give it.

I don't have any problem with consulting with Congress, and we did discuss this with some Congressional staff from time to time, and people knew it was in the works and that it was coming. Knew the varying points of view leading up to the decision.

Mr. KIND. Mr. Chairman, I appreciate the indulgence with the time. I see my time has expired. But I for one am particularly comforted with the responses, especially the response surrounding the subpoena request for information. This has been a pattern that we have detected with this administration time and time again, and unfortunately I think there's going to be required some followup with what just occurred earlier this year, with what I felt was a legitimate subpoena request for information, that was not complied with.

But thank you, Mr. Chairman.

Chairman LEWIS. Let me just say to the gentleman from Wisconsin, if necessary for another round of questions, we may be able to do just that.

Now I turn to Mr. Linder for his questions.

Mr. LINDER. Thank you, Mr. Chairman. Thank you both for being here.

Mr. Millard, what percentage of the plans out there are still defined benefit?

Mr. MILLARD. What percentage of the plans. I'm not sure.

Mr. LINDER. Many plans are going from defined benefit to defined contribution.

Mr. MILLARD. Well, they don't necessarily go from one to the other——

Mr. LINDER. Some——

Mr. MILLARD. A defined benefit plan might freeze and someone might open or not open a new defined contribution plan. PBGC doesn't have oversight of a defined contribution plan.

Mr. LINDER. Correct. So, have you given any anticipation as to how many potential problems there are out there of defined benefit plans?

Mr. MILLARD. Yes. We're concerned about under-funded status and defined benefit plans. We're concerned about the increase in freezing. Occasionally, I would even say frequently, when someone does freeze a plan, they will create a defined contribution plan. The distinction between those two is something that some people would say defined benefit plans are a better deal for the workers. Some people would say a defined contribution plan is a better deal for the worker.

Mr. LINDER. That's not the question I asked you.

Mr. MILLARD. Okay——

Mr. LINDER. I expect because of your role and your responsibility on failing defined benefit plans, that you would have some idea of how much risk there is out there in the benefit community.

Mr. MILLARD. I'm trying to answer your question. But when you say "how much risk there is out there in the defined benefit community," do you mean what's the overall underfunding in the system?

Mr. LINDER. Yes.

Mr. MILLARD. Okay. Overall underfunding in the system. We had at the end of 2006, we published a number of $350 billion of underfunding in the overall system. That number in fiscal year 2007 we believe went down, although we didn't publish it in the annual report, because we've actually come to the conclusion that our ability to calculate that number, because it's based on a lot of extrapolations and estimations, is probably something that we ought not to try to promise too much precision about. But our estimate—and it's only an estimate—is that there was about $225 billion of underfunding in the overall defined benefit system at the end of 2007. That's on a total system of about $2 trillion. So, an overall underfunding of approximately 10 percent as an order of magnitude in the overall defined benefit system.

Mr. LINDER. Thank you.

Ms. Bovbjerg, in your GAO report you pay some attention to the three-person board of directors and its oversight. Those three cabinet secretaries are pretty busy in doing other things, I assume. Did you make any recommendations as to what the board should look like?

Ms. BOVBJERG. We did not make recommendations. We had some ideas. We thought it needs to be larger. Corporate governance standards suggest anywhere from five to 15 members.

Mr. LINDER. Where should they come from?

Ms. BOVBJERG. It should probably be more diverse. It should not be 100 percent government officials. It could diversify in terms of skill, in terms of representation. We do acknowledge that the original legislation that created the board did attempt to have diversity, so that the Department of Labor represents workers, Department of Commerce represents employers, Treasury represents finance. But taking that idea further, we think would be useful. The McKinsey Report does have several suggestions about that as well.

Mr. LINDER. Thank you both. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you.

We will now turn to Mr. Pascrell for this questions.

Mr. PASCRELL. Thank you, Mr. Chairman.

Mr. Chairman, I was just looking at the chronology since July of 2007 when the GAO issued its report critical of the PBGC in the governance, structure, and practices. Then all the way through to August of 2008, I think Mr. Kind, the gentleman from Wisconsin, was on target, and I don't believe that the responses have been satisfactory. I think that this should cause greater concern for us. There is no reason to ignore requests from the Committee or anybody else, since this document is pertinent to us getting a good grasp on what's happening. I hope the Ranking Member and the

Chairman feel as I do, that there should be at least followup on this, in going in that direction.

Ms. Bovbjerg, the current market crisis has created a situation where the average taxpayer may soon find themselves bailing out some of this country's historically wealthiest corporations. So, I have a very simple question. Probably deserves a complex answer, but whatever. What is the chance that the taxpayers will be asked to provide funds to the PBGC? What's your gut feeling on this?

Ms. BOVBJERG. It's really hard to say. I'm going to have to give you the complex answer. Initially nothing. For some years to come PBGC is going to be able to pay benefits.

Mr. PASCRELL. Right.

Ms. BOVBJERG. You know, it's because when you terminate plans, there are assets that come with those plans, even though those assets are insufficient to fund all the benefits guaranteed by PBGC. There are still assets there.

Mr. PASCRELL. All right.

Ms. BOVBJERG. So, PBGC will have funds for years to come. This is not an immediate problem; but it's certainly one that in the PBGC context, you can see it coming way down the road.

Mr. PASCRELL. You have an overview of all of this that's going on in the pension systems. What do you think of the effort to change the foreign benefit plans into non-defined benefit plans? Does that have traction? What are the implications?

Ms. BOVBJERG. Really more what is happening, there's a little different dynamic. Very few defined benefit plans are newly created today. Employers are turning much more frequently to defined contribution plans. So, new plans are defined contribution plans, 401K type plans. Defined benefit plans are more likely today to be frozen than in the past; certainly that's what some of our analysis suggests. Freezing can be a step toward termination ultimately.

So, the defined benefit system really is shrinking. There are fewer new participants coming in. It's more heavily laden with current retirees. So, that's the dynamic you see out there. PBGC is insuring what over time is a shrinking system.

Mr. PASCRELL. Mr. Millard, the PBGC Single Employer Pension Insurance Program has a deficit of over $13 billion. As of last September. You reported $1.2 billion in highly likely terminations. Companies with below-investment-grade credit for firms in the finance, insurance, and real estate industries.

My question is: How much of Fannie Mae, Freddie Mac, Lehman, AIG's pension promises went unfunded?

My second question is: If these pension plans come into the PBGC, how would they affect your deficit and target date for reaching full funding? Two specific questions.

Mr. MILLARD. Yes. The actual underfunding in the plans that you talked about in specific detail, we get a more up-to-date basis from the information that's confidential that we're no allowed to share. It comes from 4010 filings and other specific—sometimes there will be a transaction going on that requires that they give us additional information that we're not actually permitted to disclosure company by company. But there are five companies that help me answer your question, I think. That would be AIG, Fannie Mae,

Freddie Mac, IndyMac, and Lehman, those five had a total underfunding in their plans of approximately $400 million.

Mr. PASCRELL. $400 million?

Mr. MILLARD. Yes. By the way, Bear Stearns had no plan, and Merrill, although it's a different conversation, also had no plan.

PBGC's obligation to cover that $400 million would only to cover $100 million of that underfunding. As you know, we don't pay the full amount of people's benefits sometimes. We have a maximum of $51,000 a year, so someone who's benefit might have been $70,000 would only get $51,000 with us. So, the hit to our deficit from those five companies would be about $100 million.

Mr. PASCRELL. So, what——

Mr. MILLARD. If they came in, and of course they haven't necessarily come to us yet.

Mr. PASCRELL. If. Right. But in this past week, what is the new dollar estimate for what you and I would consider reasonable possible terminations in the finance, insurance, and real estate——

Mr. MILLARD. We had a figure for that in our annual report, which is a December 2006 figure, which we put—because remember, we get filings, the Form 5500 doesn't get filed until 9 months after the plan year that it relates to.

Mr. PASCRELL. Yeah, but you don't get the estimates until 9 months after. But the fact of the matter is you must be monitoring this very closely. I mean what's happening in one market is affecting you every day.

Mr. MILLARD. We would like to be able get more up-to-date information about plan status than we are currently permitted to get, by law. The 4010 filings that we get are less useful to us now than they used to be under the Pension Protection Act of 2006 and the Form 5500 is only required to be filed 9 months after the year is passed. We can't require people to give us this information; although yes, we can extrapolate and try to update things. So I do have information for you that is based, I'm sorry to say, on December 2007. So, the number that your asking about was $1.2 billion of I believe it was reasonably possible exposure to the PBGC in December of 2006. That number dropped to $400 million in December of 2007. I don't have up-to-date information on the overall 5,000 companies in the financial insurance and real estate industries to tell you what that $400 million is as of today.

Mr. PASCRELL. I would think that would be very critical, wouldn't it, Mr. Millard?

Mr. MILLARD. It would great if I could get it.

Mr. PASCRELL. But can't you, use your terms, "extrapolate" from what the information that you can gather right now in order to make your prognostications——

Mr. MILLARD. The best I can do is ultimately not reliable.

But let me walk through with you a way to think about it. If you assume—and I don't believe this is a reliable assumption—but let's assume that all those plans are invested 60/40—60 percent equities, 40 percent fixed income. Let's assume that in the last 9 months the performance of the financial sector is down 10 percent, depending on how recently you want the numbers. In the last 12 months it's down 5, down 10, down 15, depending on what day you asked the question, so it's so volatile. So, let's say it's down 10. If

you assume that their 60 percent is all in the S&P, the S&P is about 16 percent financials, so that 16 percent would have dropped by 10 percent, which would be a 1.6 percent drop in the portfolios of companies that are across the board invested in a 60/40 investment.

But, as you can tell from my giving you that equation, it's not really reliable for me to say now I know that I have a bigger or smaller risk. What I need is more real time information from the companies that we cover; because they're all not all 60/40, and people are changing their portfolios all the time.

Mr. PASCRELL. Thank you, Mr. Chairman.

Chairman LEWIS. Sir, I don't quite understand. If you can just respond to Mr. Pascrell. You say you don't have the authority. It there some rule as to the law that keeps you from making certain information public? We're not asking, Mr. Pascrell——

Mr. MILLARD. No, no——

Chairman LEWIS. I don't think you were asking for the individual——

Mr. PASCRELL. I wasn't.

Chairman LEWIS. But——

Mr. MILLARD. There's two things.

Chairman LEWIS. Well, make it plain to the Members of the Committee.

Mr. MILLARD. If I have information from a specific company that they've given us from a 4010 filing, I'm not allowed by law to sit here and say Merrill-Lynch has X–Y–Z going on its portfolio. That's number——

Mr. PASCRELL. Mr. Chairman.

Chairman LEWIS. Yes, sir?

Mr. PASCRELL. Excuse me, if I may, with your permission. You may not be commanded to do that, but you certainly need that information in terms of what we're going to be doing in the future. So, why don't you have that information?

Mr. MILLARD. There's two points. We do get information from people who are on our reasonably possible list. You get on the reasonably possible list, for example, if you have a junk bond credit rating, if you have missed some of your contributions, if you have filed for a waiver, if you're having some problems, not necessarily about to go bankrupt, but you're having some problems. Then you're on our reasonably possible list. Once you're on our reasonably possible list, then you file a 4010 filings with us, and that gives us much more up-to-date information about those companies.

But AIG is not on our reasonably possible list. They are actually still an A-rated company. I know that sounds counter-intuitive, but they are. So, they don't have to file a 4010. So, I don't get that kind of information from them. I get lots of information about them in the Form 5500, but under the law the Form 5500 isn't filed until October of the year after. So, the information you would like to know about what's happening in somebody's plan right now, we will receive October a year from now.

Mr. PASCRELL. Mr. Chairman, you can understand why that's not very comforting to folks who have these pension plans. We've known what's been going on in the pension system, regardless of what area they're in.

These funds are in jeopardy. People who worked hard all of their lives—and I know you want to protect them just as much as want to protect them—and yet, for some reason we seem to be not doing what we should be doing.

This is serious business. I mean people are planning this retirement income they can count on. Our answer is, "Oh, we're 9 months behind in getting you a specific answer about what's going on right now"——

Mr. MILLARD. No——

Mr. PASCRELL. You know, you make predictions based upon the data that you can get. No one's saying that you can't get the data. You're saying you're not commanded to get the data.

Mr. MILLARD. I'm saying that the law requires that people file with us 9 months after the time that we'd be interested in the information, and the we do not have the right to insist that plans not subject to 4010 filing provide us that information.

I think it would be irresponsible for me to try to tell you from extrapolated numbers, as I tried to demonstrate a moment ago, what underfunding is in specific companies or even industry sectors, simply by extrapolation of 9-month and 10-month and 12-month-old data, particularly in markets that are so volatile that I can tell you what something is today and tomorrow it could change by 10 percent.

Mr. PASCRELL. Mr. Millard, let me tell you something, very clearly, very succinctly. I don't buy that. I don't buy it because this perfect storm didn't happen 2 weeks ago. It's been gathering. It would seem to me in the position that you're in—and who is the head of the your board?, the Secretary of Labor?—I would be absolutely honed in, focused on what is happening in the general economy, what is happening on Wall Street, so that I can prepare for what is happening.

Pensions have been under attack for many years now. This is nothing new we're talking about here.

Mr. MILLARD. Yes, Congressman——

Mr. PASCRELL. We didn't invent the discussion.

Mr. MILLARD. That is why in the Pension Protection Act, we asked for better 4010 filing information on a more current basis, and we didn't get it.

Mr. PASCRELL. When was that?

Mr. MILLARD. Pension Protection Act 2006.

Mr. PASCRELL. Oh——

Mr. MILLARD. Because we knew that there was a problem.

Mr. PASCRELL. You have a different Congress, you have a different——

Mr. MILLARD. We asked Congress to give us more information on a more timely basis. Congress did not do so.

Mr. PASCRELL. Well, I think that's the direction we should be going in. You should be doing it without our command.

Thank you.

Chairman LEWIS. Thank you very much.

Mr. Johnson, I know you've been waiting so patiently. We turn to you for your questions.

Mr. JOHNSON. Thank you for allowing me to join you today. I appreciate it——

Chairman LEWIS. Delighted to have you, Mr. Johnson.

Mr. JOHNSON. You know, when we put that Pension Benefit Act together, there were some ideas that if a company was doing okay and not, you know, in trouble, we didn't there to push them for information. It's the ones that declare bankruptcy before we're in a bankruptcy status that had to start reporting to him. I think you remember that. The problem we got today with these guys is they didn't ever get classed as bankrupt. You know that. AIG, for example.

Let me ask you a question, Mr. Millard and Ms. Bovbjerg. The Pension Protection Act required companies to match the asset investment horizon to their liability or benefit payment horizon. Do either of you have any feedback on how this is working for pension plans?, and does the new investment strategy of PBGC follow its predicted liability payment horizon? If not, why not?

Mr. MILLARD. I'm sorry. I missed the first part of that question. Would you mind just repeating it please?

Mr. JOHNSON. Sure. The Pension Act required companies to match their asset investment horizon to their liability or benefit payment horizon. Do you have any feedback on how that's working?

Mr. MILLARD. Hmm, I think if I could comment, let me take it to the PBGC's investment policy. I think that in 2004 the prior investment policy at PBGC was more asset liability matching, as you've mentioned, and the new investment policy is more targeted over the long term to try to make sure we increase the chances that we will be able to pay our liabilities over time.

The principal guideline or the principal objective of the new investment policy is to say, "Look, we know that Congress has said the U.S. Government doesn't stand behind PBGC's liabilities, and we need to do the best that we can without taking undue risk to maximize the chance that we will be able to pay those bills, so we won't have to come to Congress for a $14 billion bailout."

If you have $82 billion of liabilities and $68 billion of assets, and you engage in excellent asset-liability matching, then you will have of course retained for the future the $14 billion deficit. Each will go up together, each will go down together, and then some day we'll come to Congress and say, "How about the $14 billion?" The new investment policy is designed to increase the likelihood that we will not need to come to Congress for that money without taking undue risk in the portfolio.

Mr. JOHNSON. Ms. Bovbjerg, do you have a comment?

Ms. BOVBJERG. Well, let me just summarize GAO's work on the investment policy. Our concern about the policy is that while, in fact, returns seem likely to rise, so too does risk, and that we did not feel that the risk level represented in the new policy was adequately acknowledged or analyzed appropriately. We thought that that was information that the board should have had in making this decision.

Mr. JOHNSON. Thank you.

Mr. Millard, in the Pension Protection Act there were special provisions granted to the airline industry regarding their funding. I wasn't a big fan of industry-specific relief at that time, but an ardent supporter of making sure Congress didn't pick winners and

losers, once the decision was made. Could you tell me whether the additional time the airlines were given to fund their pension obligations has caused problems so far for the PBGC?, and have all the major airlines that were turned over to you taken advantage of the additional time Congress gave them to fund their pension obligations? As you know, most of the major airlines—United, USA, Delta, Pan American, and Trans World, are all under you now, and it seems to me there are only two that are still sitting out there with pension plans—American and Continental.

Mr. MILLARD. Right. The ones that have folded, obviously, you know, have not been able to take advantage of any of those provisions; but the ones at issue have taken advantage of the provisions. But you ask if it's posed any problems for PBGC. In a sense I have to say "not yet," because the amount of underfunding, without being too specific in those plans, remains very high, and their required contributions remain at low or zero, because of those provisions.

That means that the workers who are the intended beneficiaries of those plans face a situation in which the amount of underfunding, should those airlines file for bankruptcy again and not be able to support those plans, that amount of underfunding is likely to be substantially higher than it would be if they were meeting the provisions that other companies have to meet in the Pension Protection Act of 2006.

Mr. PASCRELL. Well, about 41 percent of your claims or responsibility is from the airline industry, I think. Are you able to meet those without worrying about defaulting?

Mr. MILLARD. Well, 76 percent of all the claims we've ever taken in are steel and airlines. So we have been able to meet our obligations over all that time, yes.

But if you calculated the airline relief, if you calculated the airlines who were subject to airline relief the same as we calculate every other company, then our deficit wouldn't be $14 billion; it would have been at the end of 2007 about $22 billion.

Mr. JOHNSON. Thank you, Mr. Chairman. I appreciate the time.

Chairman LEWIS. Thank you, Mr. Johnson.

We now turn to Mr. Pomeroy for his questions. Welcome, Mr. Pomeroy.

Mr. POMEROY. Mr. Chairman, thank you for having this hearing and thank you for allowing me to participate. So, many issues, so little time.

Let's continue to focus on this asset-liability match question, because I really do think it's important for us to get a handle on that, as well as evaluation whether in responding to the financial crisis, if we care about keeping pensions, we need to give some relief to the terms of the Pension Protection Act, which is essentially a mark-to-market proposition.

Now you mentioned that in 2006 you reported a $350 billion underfunding, and that's out of how big a fund?

Mr. MILLARD. Out of a total universe of approximately $2 trillion.

Mr. POMEROY. Out of a $2 trillion fund. You also——

Mr. MILLARD. Not a fund, that's the overall universe. That's the universe of all defined benefit plans in the United States, not our fund.

Mr. POMEROY. Oh, thank you for that clarification. So, out of the defined benefit universe of $2 trillion, the snapshot on a mark-to-market accounting basis, shows a $350 billion underfunding and the very next year that had dropped to $225 billion because the market had recovered somewhat. Is that correct?

Mr. MILLARD. Estimated numbers, but yes.

Mr. POMEROY. So, basically, the pension obligations, which are owed over many years, will in some ways be—this mark-to-market doesn't make a lot of sense, because basically mark-to-market means you essentially would have to liquidate your assets and match against presently payable liabilities. But the reality is the pension liability goes over many years. So, mark-to-market snapshots are going to be up, they're going to be down, they're going to vary. But they may not have a lot to tell you about the strength of the fund. Is that correct?

Mr. MILLARD. I think that's a fair characterization.

Mr. POMEROY. The discussion today has gone far and wide. There are so many issues of concern I'd like to talk to you about regarding governance, regarding the Secretary of Labor not having the slightest notion about what an investment policy is, the tendency to sell low and buy high in the management of the investment fund. On and on.

But I'm not going to get into that, and I'm not going to get into the really slimly looking appearance of your predecessor, the former PBGC director, who pushed the Pension Protection Act because all these pensions were insolvent, and now wants to go and run off those pension liabilities as part of a hedge fund profit-making proposition. I won't talk about any of that.

[Laughter.]

Mr. POMEROY. Because we have issues that are more important to focus on, and that is these pensions.

I quote from yesterday's front page New York Times stories on how retirees are doing in the middle of this financial storm. "As companies have switched from fixed pensions to 401K accounts, retirees risk losing big chunks of their wealth and income in a single day's trading, as many have in the past month." Article goes on to say, "Today's retirees have less money and savings, longer life expectancies, and greater exposure to market risk than any retirees since World War II." Do you agree with that sentence?

Mr. MILLARD. I don't think I can take a position on the sentence. I'm following your point——

Mr. POMEROY. Okay. We'll, I'll tell you why I agree with it. I agree with it because we've had the number of pensions declining, and now only have about 20 million workers covered; but it represents a substantially smaller share than were covered earlier, and that those who have defined benefit pensions today don't really to have to worry about this financial crisis in the same those that are self-managing their 401K account, because they're going to get an annuity payment, come what may. That annuity payment is insured by the Pension Benefit Guaranty Fund. Now, do you agree with that?

Mr. MILLARD. Yes.

Mr. POMEROY. I note that in the ERISA law that establishes your position, there is a provision, and I quote, "to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants." So, do you view as part of your responsibilities doing what you can to keep pensions functioning and healthy?

Mr. MILLARD. Yes. What we can, certainly.

Mr. POMEROY. The pension study of the GAO indicates that the two main reasons driving the freezing of pension plans is the cost of funding the pensions, and the volatility of funding the pensions. Do you agree with that?

Mr. MILLARD. I think those are two very important considerations, yes.

Mr. POMEROY. Here's what worries me about the time we're in. Market valuations are depressed, severely depressed. You might say hysterically depressed. One of the reasons the Secretary of the Treasury is up on Capitol Hill, working on this so-called bailout proposition, is to try and infuse liquidity and confidence into the marketplace, because present valuations really don't reflect the value of the assets. Do you agree with that?

Well, let me put it this way. Do you agree that market valuations today may be below the highly probable value of the assets?

Mr. MILLARD. They may be below? Sure, I'll agree with that.

Mr. POMEROY. Well, I'd even say they're probably likely to be below. I believe one of the reasons the Secretary of the Treasury continues to talk about potential upside of the taxpayer helping is because he expects them to perform better than market valuation.

Here's what's worrying me. If on the more or less mark-to-market accounting rules now passed by Pension Protection Act, we take a snapshot of what these companies are going to owe to fund their pensions this year, they're going to see that the pension assets held have diminished in value in light of the market problems, and that therefore they're going to have to fund more highly.

There are two provisions that fell short in the Pension Protection Act of 2006. One is smoothing—this business of where amounts owed is levelized somewhat over time. Congress should have passed it in the Technical Corrections Act. It has not passed it yet. I believe there's an imperative to pass the smoothing on funding.

But there's another provision as well, and this is: If the fund falls below the target for the year, if the funding of a plan falls below certain levels, they have to fund it even more to get it back up to 100 percent. I believe that this year's funding requirement is 94 percent. Those under 94 percent will have to fund up to 100 percent, as opposed to 94 percent. Are you aware of that provision of the Pension Protection Act of 2006?

Mr. MILLARD. Yes.

Mr. POMEROY. Do you believe that it's possible that could have a draconian impact on companies in light of the depressed market valuations of their pensions?; they're going to be below that 94 percent, and at a time when their own business is challenged by this challenging economic environment, they're suddenly going to have to pay more for their pension, because they're going to have to

bring it up to 100 percent, even though it's 100 percent of very depressed asset valuations in their portfolio. Do you agree with that?

Mr. MILLARD. Well, I think that the potential for market volatility, you know, as was stated a moment ago, we've known about lots of these issues for a long period of time——

Mr. POMEROY. Come on, give me a straight answer to this one. Give me a straight answer to this one. Is it highly likely——

Mr. MILLARD. My straight answer to you is: We knew there was going to be volatility when the Pension Protection Act passed, knowing that some times there is a lot of volatility, nonetheless, adopted as a policy that we want people to fund up. If we want to change that policy, that's a whole discussion that goes beyond, I think——

Mr. POMEROY. Okay. Mr. Director, if you knew that we were going to be in this situation, I sure in the world wished you'd have told the Fed and I wished you had told the Treasury, and maybe even bother to call President Bush while you were at it, because I believe most of us are highly surprised about the economic environment we are in.

Now, given the economic environment we are in, do you want these plans to fund up to 100 percent?

Mr. MILLARD. I think the people should comply with the terms of the Pension Protection Act as Congress wrote it.

Mr. POMEROY. I think that you might want to comply with the law, which you are sworn to uphold. Let me read it to you one more time. "To encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participant." Do you think that asking them to fund up in this market environment to 100 percent of what the market is evaluating their assets to be worth is consistent with your sworn responsibility to encourage the continuation and the maintenance of voluntary pension plans?

Mr. MILLARD. Congressman, my job is to enforce the law as Congress passed it. Congress passed a law that requires this.

Mr. POMEROY. Now this is very interesting. Do you believe that we repealed this part of your law?

Mr. MILLARD. No, sir.

Mr. POMEROY. You know, here's the point——

Mr. MILLARD. But——

Mr. POMEROY. I know you have to enforce what you have to enforce. But it would seem to me that you might be offering us some counsel, some leadership, some guidance relative to the imperative of getting smoothing passed.

I think it's abhorrent that Congress has failed to smoothing. It's ridiculous that we have failed to do that. So, we'll certainly accept our share of the burden.

But in addition to that, this business of funding up, which you seem to indicate is still a realistic pension-funding policy, even with the mark-to-market issues relative to depressed asset valuation, are you still in favor of this part of the Pension Protection Act?

Mr. Chairman, just if you'd indulge me so he can answer this last part of the question.

Mr. MILLARD. I think if you're asking me: Does the administration have a position on changing the Pension Protection Act?, no we do not now have a position on changing that act.

Mr. POMEROY. Do you believe the 100 percent is appropriate in this market valuation, as a matter of counsel to Congress, being the pension expert in the Federal Government?

Mr. MILLARD. As I just said, I don't think the administration currently has a position on changes like that——

Mr. POMEROY. As the director being the expert—so you're precluded from offering your expertise?

Mr. MILLARD. Well, so far I've been aware of this general idea of a change for approximately an hour and 25 minutes. So, I think it's probably better if I gave it a little bit more thought than that.

Mr. POMEROY. I encourage your thinking on it, and I'm a little distressed to hear that this is such a fresh notion to you.

I yield back, Mr. Chairman.

Mr. MILLARD. If I may, Mr. Chairman, I'd like to take exception to two things. I do not believe that the characterization of the Chairman of Board, Elaine Chow, as not having the slightest idea about investment policy is objectionable and not consistent with my experience.

Mr. POMEROY. As a matter of record before the Committee on Ways and Means and a question that I asked the Secretary of Labor as to whether the investment policy of the board had been changed to move to a more conservative position in equities, and she said it had not been changed. That was controverted by signed minutes that she signed as Secretary of Labor. Now she either actively misrepresented—and that's a possibility, I wasn't thinking about that—or I thought it reflected just abject ignorance of what was going on in her responsibilities as trustee.

I yield back.

Mr. MILLARD. In my experience, there is no abject ignorance or purposeful misrepresentation by the Secretary of Labor.

Mr. POMEROY. Why would she give an answer like that?

Chairman LEWIS. Maybe at another time and another place, we can have maybe the director and the Secretary of Labor both to come before the Committee.

Mr. POMEROY. I'd welcome that opportunity, Mr. Chairman.

Chairman LEWIS. Let's work on that.

Thank you very much.

Now turning to Mr. Tiberi for this questions. Welcome.

Mr. TIBERI. Thank you. Thank you, Mr. Chairman.

Chairman LEWIS. I haven't seen you in a while.

Mr. TIBERI. I've been around.

Chairman LEWIS. We haven't been meeting, I guess. Good to see you.

Mr. TIBERI. Yes. Good to see you, Mr. Chairman,

Chairman LEWIS. I miss seeing you.

Mr. TIBERI. I miss seeing you, and I will also miss seeing Mr. Ramstad next year.

Mr. RAMSTAD. Thank you.

Mr. TIBERI. It's been a pleasure to be with you.

Chairman LEWIS. Let me share some things about him——

[Laughter.]

Chairman LEWIS. We're all going to miss him.

Mr. TIBERI. Thank you.

Thank you both for testifying today. Just a question for both of you. Are there any changes to ERISA that GAO would recommend to help minimize underfunded plans?

Ms. BOVBJERG. I was thinking it might just stop with "Are there any changes to ERISA that we would recommend?"

Mr. TIBERI. We could stop there too.

Ms. BOVBJERG. We've recommended many. With regard to underfunded plans——

Mr. TIBERI. To help minimize the underfunding of plans?

Ms. BOVBJERG. Honestly, I think that we did learn from the experiences with Bethlehem Steel and United Airlines, and the way that the funding rulers played out in those instances. Those were the two largest claims ever made on PBGC. It was all done within the funding rules. So, you know, I've listened to the funding rule discussion with a lot of interest, because I think the intent in PPA is to balance the clear needs of the PBGC to have better funding and plans, but at the same time trying not to drive employer sponsors out of the defined benefit business. I think what we're really talking about here is where do, how do you calibrate that balance?

The reason I don't have direct advice for you on this today is I think that in this particular economic environment we really have to step back and see what is going to happen out there, what is going to happen as the funding rules start to really bite for employers and their contributions, what will happen to some of the businesses that may be teetering and are on the probables or the reasonably possible lists.

Mr. TIBERI. Director, any thoughts from your perspective?

Mr. MILLARD. I really would reiterate what Ms. Bovbjerg said. The real effect of the Pension Protection Act, which did have the goal of balancing, as she just described, really isn't something that we can tell yet. Those provisions are really just beginning to kick in. I think it did try to say we don't have more Bethlehem Steels in the future, and as we see people fund up, hopefully we won't. Obviously making them too expensive, if that's the right expression, is not a goal either; and I think it's too early to tell the results of that bill.

Mr. TIBERI. How long do you think it should take before we know?

Mr. MILLARD. At least a few years. I mean it's not the kind of thing that you can tell; because the markets are so volatile, it's hard to say what effect 1 year or 2 years is going to have on an overall system complying with the new law.

Mr. TIBERI. Do you agree with that?

Ms. BOVBJERG. Actually, I wanted to jump in a little bit different issue; which is I think that the defined benefit issues that we're going to see in response to the current economic turmoil actually won't happen as fast as some of the things that have happened in the last 2 weeks. It will take a while to see that play out and to affect participants.

But as Mr. Pomeroy just pointed out in the article in the New York Times, they got it right on 401Ks. Particularly older people

don't have patient capital; they may not be able to wait all this out. We have been concerned for a long time that people are not saving enough in 401Ks, and now discover that what they were saving is being eroded by market change, which is, you know, what risk is all about.

So I guess I just wanted to take the opportunity to remind the Subcommittee that there is a big world of defined contribution pensions out there and that those are going to be the places where people are going to feel the most direct pain the most quickly.

Mr. TIBERI. Thank you. Thank you, both. I yield back.

Chairman LEWIS. Thank you very much.

Mr. Pascrell is recognized for an additional question.

Okay. It's my understanding that Mr. Kind is prepared and ready to yield to you, and then we will come back to him for a short question.

Mr. PASCRELL. Thank you, Mr. Chairman. Thank you, Mr. Kind.

Mr. Millard, so please tell me. Currently the PBGC needs more negative financial triggers in order to demand financial information from companies, correct?

Mr. MILLARD. Yes.

Mr. PASCRELL. So, the law as it stands only allows you to do so at the point where bankruptcy occurs, correct?

Mr. MILLARD. Not only then, no. But that's the kind of——

Mr. PASCRELL. Well, where else?

Mr. MILLARD. Hmm, we get 4010 data based on certain transactions that might happen——

Mr. PASCRELL. What changes actually? Which transactions? Give me an example.

Mr. MILLARD. The purchase of Chrysler by

Mr. PASCRELL. I'm sorry?

Mr. MILLARD. The purchase of Chrysler by Cerberus.

Mr. PASCRELL. What happened there?

Mr. MILLARD. We did engage. We got the information. We insisted that——

Mr. PASCRELL. But what triggered it off?

Mr. MILLARD. Sale, the change of control.

Mr. PASCRELL. Change of control. So, every change of control you have the authority to review that?

Mr. MILLARD. Yes. They have to file with us.

Mr. PASCRELL. Under the law?

Mr. MILLARD. Yes, sir.

Mr. PASCRELL. So, have you asked for the authority to demand such financial information? Have you asked for that?

Mr. MILLARD. I don't believe we've asked for that specific authority. We did ask for substantially greater author in the Pension Protection Act and were denied it. We also did not way—by the way, the 4010 information that we now get after the Pension Protection Act is less useful to us than the 4010 information that we used to get, because now people file based on a percentage of underfunding. Well, if you have the $100 million plan and you're 20 percent underfunded, that's far less concern to me than if you have a $10 billion plan that's 10 percent underfunded. But the first company I just described has to file a 4010, and the second does

not, because Congress changed the provisions under which people have to require a 4010.

Mr. PASCRELL. So, if you did have the specific authority that we're talking about here—and we each understand each other—it would seem that it would assist us in the Congress, it would assist you in taking a preventative measure—and this is what I was trying to get at before—against future potentially damaging downturns in the economy, wouldn't it?

Mr. MILLARD. Yes. I mean I don't know how much it can help us, but of course it can help us some. If someone is having a problem and we know the information, we can try to go in and insist and negotiate, use whatever leverage we have to try to get them to increase their funding——

Mr. PASCRELL. Particularly if there are a lot of companies having the problem at the same time.

Mr. MILLARD. When we get that information, we frequently do take that kind of action to try to get more money into pension plans—and the Daimler-Chrylser situation is a very, very good example—we persuaded them because they wanted us to agree to certain provisions of their transaction, to put $200 million more into their pension plan than the law required.

Mr. PASCRELL. Would you ask for that authority today?

Mr. MILLARD. Would I ask for which authority?

Mr. PASCRELL. The very authority I talked about. You know, the authority to demand specific financial information?

Mr. MILLARD. I think if we had that authority, that would be great.

Mr. PASCRELL. So, you're asking for it?

Mr. MILLARD. Yes.

Mr. PASCRELL. I didn't ask you if you thought it would be great.

Mr. MILLARD. Yes——

Mr. PASCRELL. I asked you would you ask us to do it?

Mr. MILLARD. Yes.

Mr. PASCRELL. Well, would you ask us?

Mr. MILLARD. I would ask you for the ability to demand certain information of certain companies, based on our view that they may have some underfunding problems.

Mr. PASCRELL. Well, good, we're going to accomplish something today, Mr. Chairman. Thank you.

Thank you, Mr. Millard. Appreciate that.

Chairman LEWIS. Thank you very much.

Now I turn to Mr. Kind for his question.

Mr. KIND. Mr. Chairman, I don't have any further questions for the panel, but I do appreciate their indulgence today, and hopefully we will receive better cooperation from a legitimate requests for information in the future, whether it's PBGC or any other Federal agency that we're requesting information from.

But I want to conclude by echoing the sentiments that you expressed, opening the hearing. Now this is Mr. Ramstad's last hearing as a Member of Congress, and I have had great pleasure serving with him. It was way too short. He has been the model of civility and class and hard work and reasonableness, all the character traits you want to see more of rather than less of in Congress. We

are going to miss you, Jim. We love you. But we wish you all the best and God speed in your future endeavors. Hopefully you're not going to be a stranger around these places.

Thank you.

Mr. RAMSTAD. Thank you.

Chairman LEWIS. Now I turn to Mr. Pomeroy for a short question.

Mr. POMEROY. Mr. Chairman, not even a question, just a comment to you and for our Committee colleagues. I had an estimate done by a pension expert, and it assumed a 12.5-percent decline in asset values for the top 100 defined benefit plans from last year to this year.

Given what's happened to their market holdings, I believe that that's fairly realistic or maybe even conservative that the value of their portfolio in light of market valuations would have declined 12.5 percent—what impact that would have on funding levels? Well, compared to last year, we would have of the top universe of 100, 15 in that 80–93 percent funded category. This would move it up to 44 of the 100, at which time draconian funding requirements would trigger, that not only require them to fund up to the 94 percent but require them to fund up to the 100 percent of funded level, based on severely depressed values of their stockholdings.

So, we know what's happened to the stock market. It's substantially declined. So the value of the pension reflects the diminished values. So, we're asking the employer on a voluntary funding basis to put cash in so you're all the way up to the 100 percent, even at depressed market values.

Now the Pension Benefit Guaranty Corporation has told us this morning, they haven't looked at this, they haven't thought about this. I'll tell you, I've looked at it and I've thought about it, and I think that it's going to cause plans to freeze all over the country at a rate we've never seen before. A frozen pension plan hurts its participants.

So, as we look at how we respond to the financial crisis in the next few says, I believe we have to look at some relief under this pension funding, or the very thing we've been talking about that's giving retired workers stability in this market, will be going away for workers that are still in the workforce and counting on their pension plans.

So, I'll add this staff memo to me, reflecting these matters to the record, with your permission, and look forward to working with you, Mr. Chairman.

Chairman LEWIS. Same to you, Mr. Pomeroy.

Mr. POMEROY. You bet.

Chairman LEWIS. Thank you very much for bringing it to our attention.

I want to thank the witnesses for their time and their testimony. The Subcommittee appreciates your views.

Is there any other business to come before the Subcommittee? There being no further business, the hearing is adjourned. Thank you very much for being here today.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

[No submissions for the record]

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